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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 521

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

EDITH ANDREWS LOGAN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 21, 1930
CERTIORARI GRANTED DECEMBER 1, 1930

(35443)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 521

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

EDITH ANDREWS LOGAN

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 5508

EDITH ANDREWS LOGAN, 814 STAMBAUGH BLDG., YOUNGSTOWN, O.

v.

COMMISSIONER OF INTERNAL REVENUE

For taxpayer: Millard Fillmore Tompkins, Esq., 30 Broad St., New York; Walter M. Anderson, Esq., John W. Ford, Esq. For commissioner: J. D. Foley, Esq., L. C. Mitchell, Esq. Mr. Smith, member.

Docket entries

1925

July 13—Petition received and filed.
July 16—Copy of petition served on solicitor.
July 16—Notification of receipt mailed taxpayer.
Aug. 4—Answer filed by solicitor.
Aug. 11—Copy of answer served on taxpayer. Assigned to 12/9/25.
Dec. 8—Stipulation for transfer to reserve calendar filed.
Dec. 11—Order placing on reserve calendar B, signed and filed. Both sides notified.

2]1926

Sept. 7—Hearing set for 10/26/26.
Sept. 7—Hearing had before Messrs. Sternhagen and Love, on taxpayer's motion that it remain on res. cal: together with No. 5916, 5917, and 5918 pending decision of Docket 4447 and 5461. Motion granted.
Sept. 9—Ordered that proceedings remain on res. cal. together with #5916-17-18 for hearing pending the Decision of Docket 4447 & 5461, signed and filed. Both sides notified.
Sept. 25—Notice that hearing 10/26/26 be disregarded.

1927

Mar. 22—Hearing set 5/16/27.
May 3—Motion for a continuance to Sept. 12, 1927, filed by taxpayer.
May 5—Granted to Oct. 12, 1927. Both sides notified.
Sept. 22—Ordered—Hearing date changed to Nov. 8, 1927, on merits. Signed & filed. Both sides notified.
Nov. 7—Motion to continue to 1/10/28 or thereafter, filed by taxpayer.
Nov. 7—Granted to Jan. 17, 1928. Both sides notified.

1928

Jan. 17—Hearing had before Mr. Smith on merits. 60 days allowed to file briefs. Agreed statement of facts filed.
Jan. 21—Transcript of hearing 1/17/28 filed.
Mar. 9—Agreed statement of facts, proposed findings and brief filed by taxpayer.

Mar. 14—Brief filed by G. C.
June 15—Order of redetermination entered.
June 14—Findings of fact and opinion rendered. Mr. Smith. Judgment will be entered for the commissioner.
Dec. 12—Supersedeas bond for $44,097 approved and ordered filed.
Dec. 13—Notice of appearance of Chas. D. Hamel and E. H. McDermott filed.
Dec. 13—Stipulation of venue filed. 2nd Circuit.
Dec. 13—Petition for review by U. S. Circuit Ct. of Appeals (2nd) with assignments of error filed by taxpayer.
Dec. 13—Proof of service filed.

1929

Feb. 1—Motion to enlarge time to 4/1/29 to prepare evidence, etc., filed by taxpayer.
Feb. 5—Order enlarging time to April 1, 1929, for preparation of evidence and transmission and delivery of papers—entered.
Mar. 19—Motion to enlarge time to 6/1/29 for preparation of evidence and transmission of record filed by G. C.
Mar. 20—Order enlarging time to June 1, 1929, for preparation of evidence and delivery of record papers—entered.
May 29—Motion to enlarge time to July 1, 1929, for preparation of evidence and delivery of record filed by G. C.
June 1—Order enlarging time to July 1, 1929, for preparation of evidence and transmission and delivery of record papers entered.
4 June 21—Motion for extension to Aug. 1, 1929, to file statement of evidence and transmit record filed by taxpayer.
June 24—Order enlarging time to Aug. 1, 1929, for preparation of evidence and transmission and delivery of record papers *sur* petition entered.
Aug. 1—Motion for enlargement of time to 8/31/29 to prepare evidence and deliver record filed by taxpayer.
Aug. 1—Order enlarging time to Aug. 31, 1929, for preparation of evidence and delivery of record entered.
Aug. 27—Transcript of hearing Aug. 16, 1929, filed.
Aug. 29—Motion for extension to Sept. 15, 1929, to file statement of evidence and transmit record filed by taxpayer.
Aug. 30—Order enlarging time to 9/16/29 for preparation of evidence and delivery of record—papers—entered.
Sept. 14—Motion for extension to Oct. 15, 1929, to file statement of evidence and transmit record filed by taxpayer.
Sept. 16—Order enlarging time to Oct. 15, 1929, for preparation of evidence and transmission and delivery of record entered.
Sept. 27—Agreed praecipe filed.
Sept. 27—Agreed statement of evidence lodged.
Sept. 30—Agreed statement of evidence approved and ordered filed.

5 Now, October 3, 1929, the foregoing docket entries certifies from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[SEAL.]

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed July 13, 1925

Docket No. 5508. [Title omitted.]

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his letter (IT:PA:1-60D VMW-104) dated June 20, 1925, and as the basis of her appeal sets forth the following:

(1) The taxpayer is a resident citizen of the United States, whose address is 814 Stambaugh Building, Youngstown, Ohio.

(2) The deficiency letter, copy of which is attached, was mailed to the taxpayer on June 20, 1925.

6 (3) The tax in controversy is income tax for the years 1915 to 1920, inclusive, and is more than $10,000.00 to wit, $22,048.63.

(4) The determination of the tax shown in the deficiency letter is based upon the following errors. The Commissioner of Internal Revenue has erred:

(1) In adding to the net income reported in the returns filed by the taxpayer for the years 1917 to 1920, inclusive, under the general and erroneous description "ore payments received from the Youngstown Sheet & Tube Company less returns of capital thereon," the following sums, to wit:

1917	$6,677.55
1918	7,588.52
1919	19,307.46
1920	11,685.44

and adding to net income reported in the returns filed by the taxpayer for the years 1917 to 1920, inclusive, any sums whatever in respect of the transactions so described.

(2) In treating as taxable income for the years 1917 to 1920, inclusive, any portion of the sums received by the taxpayer during those years as part of the sale price of shares of stock in the Andrews
7 and Hitchcock Iron Company which were sold during the year 1916, the sums received during the respective years being the following:

1917	$9,900.00
1918	11,250.00
1919	28,785.60
1920	17,421.79

The facts upon which the taxpayer relies as the basis of her appeal are as follows:

(1) Prior to March 1, 1913, and continuously to March 11, 1916, the taxpayer owned 250 shares of the capital stock of the Andrews and Hitchcock Iron Company the value of which at March 1, 1913, exceeded the cost of the shares to the taxpayer.

(2) At March 11, 1916, the outstanding stock of the Andrews and Hitchcock Iron Company consisted of 4,000 shares.

(3) On March 11, 1916, the stockholders of the Andrews and Hitchcock Iron Company sold to the Youngstown Sheet & Tube Company for $2,200,000.00 in cash and a sum to be thereafter paid equal to 60% per ton of iron ore to the delivery of which from the Mahoning Ore & Steel Company, the Youngstown Sheet & Tube Company should thereafter be entitled as an incident of the ownership by the Andrews and Hitchcock Iron Company of one-
8 twelfth of the capital stock of the Mahoning Ore & Steel Company; the payments to be made annually on the basis of the ore to the delivery of which the Youngstown Sheet & Tube Company should become entitled during each year.

(4) Prior to March 1, 1913, and continuously to March 11, 1916, Louisa Andrews, mother of the taxpayer, owned 1,100 shares of the capital stock of the Andrews and Hitchcock Iron Company which shares were sold in 1916 as above set forth and by a bequest in the will of said Louisa Andrews, the taxpayer received a one-half interest in the estate and became entitled to receive 550/4000ths of the unpaid purchase price at the date of her mother's decease which occurred March 22, 1917.

(5) During the years 1917 to 1920, inclusive, the taxpayer received as part of the sale price, the following sums, to wit:

1917	$9,900.00
1918	11,250.00
1919	28,785.60
1920	17,421.79

(6) The aggregate sum of the amounts received by the taxpayer prior to December 31, 1920, as part payment of sale price of the 250 shares owned prior to March 11, 1916, including her share of
9 the consideration of $2,200,000.00 in cash paid in 1916, was less than the value at March 1, 1913, of said 250 shares.

(7) The aggregate sum of the amounts received by the taxpayer prior to December 31, 1920, in respect of the unpaid sale price at the date of her mother's decease was less than the value fixed upon her interest for the purpose of the Federal estate tax.

(8) The taxpayer keeps no books and the returns of the taxpayer for the years 1916 to 1920, inclusive, were made upon the basis of cash receipts and disbursements.

The taxpayer in support of her appeal relies upon the following propositions of law:

(1) That in the case of a taxpayer who keeps no books, the taxable income must be determined upon the basis of cash receipts and disbursements.

(2) That in the case of sale of property acquired before March 1, 1913, such as shares of stock, the aggregate amount of the income taxable at any time or times can in no event be greater than the excess of the consideration received over the fair value of the property at March 1, 1913.

(3) That in the case of property acquired under a will, taxable income can, in no event, exceed the value of the property at the date of the death of the testator.

10 (4) That in the case of the sale of property for a consideration which is indeterminate (prior to the date of the last payment to be made) no taxable income arises until the aggregate consideration received exceeds the amount which is to be returned to the taxpayer free of tax and that after this amount has been returned all subsequent receipts are taxable income.

(5) That in the case of the conversion of property received from a decedent estate the amount to be received in respect of which is indeterminate (prior to the date of the last sum to be received in respect thereof) no taxable income arises until the aggregate sum received exceeds the value of the property at the date of the death of the decedent.

Wherefore the taxpayer respectfully prays that this board may hear and determine its appeal.

WALTER M. ANDERSON,
Counsel for the Taxpayer, Greenwich, Conn.

Verification

STATE OF CONNECTICUT,
County of Fairfield, ss:

GREENWICH, *July 7, 1925.*

Walter M. Anderson, being duly sworn, deposes and says that he is the duly constituted attorney of the taxpayer in whose behalf the foregoing petition is submitted; that the taxpayer is
11 absent from this country; that he has read the same petition and is familiar with the statements contained therein and that the facts therein stated are true to the best of his knowledge, information and belief.

WALTER M. ANDERSON.

Sworn to and subscribed before me, this 7th day of July, 1925.
[SEAL.] (S.) PERCY D. ADAMS,
Notary Public.

(Copy)

TREASURY DEPARTMENT,
Washington, June 20, 1925.

IT:PA:1-60D.
VMW-104.

MRS. EDITH ANDREWS LOGAN,
814 Stambaugh Building, Youngstown, Ohio.

MADAM: The determination of your income tax liability for the taxable years 1915 to 1920, inclusive, as set forth in office letter dated August 8, 1923, has been changed to disclose a deficiency in tax amounting to $22,048.63 for the years 1918, 1919, and 1920, and overassessments amounting to $1,951.48 for the years 1915, 1916, and 1917. The adjustments made are explained in the attached statement.

12 In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the enclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA:1-60D:VMW-104. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR,
Commissioner.
By J. G. BRIGHT,
Deputy Commissioner.

Enclosures:
Statements.
Agreement—Form A.

13 Statement

IT:PA:1.
VMW-104-60D.

In re: Mrs. Edith Andrews Logan, 814 Stambaugh Building, Youngstown, Ohio.

	Deficiency in tax	Overassessment
1915 (claim filed)		$18.60
1916 "		1,441.15
1917 "		491.73
1918 (waiver filed)	$994.05	
1919 "	14,277.92	
1920	6,776.66	
Totals	22,048.63	1,951.48

Your income tax liability has been adjusted in accordance with the recommendation of the former Committee on Appeals and Review as follows:

1915

Net income reported by revenue agent		$35,738.79
No adjustments.		
Personal exemption	$3,000.00	
Cash dividends	44,567.50	
		47,567.50
Surtax on net income		157.39
14 Original tax assessment:		
March, 1916—Folio 26, Line 15	105.06	
Additional tax assessment:		
March, 1920, page 9, line 0	74.93	
		179.99
Overassessment		22.60
To be abated—Form 47 filed April 30, 1920	18.60	
Not allowable—no claim for return filed	4.00	
		22.60

1916

Net income reported in original return			$19,151.16
Deduct:			
Overstatement of dividends received from Carbon Limestone Co	$2,500.00		
Add:			
Erroneous deduction of expenses	$490.00		
Understatement of interest received	50.00		
		540.00	
			1,960.00
Adjusted total net income			$17,191.16
15 Cash dividends		27,320.25	
Personal exemption		3,000.00	
			30,320.25
Tax assessment March, 1920, page 9, line 1		1,441.15	
Total tax due		None.	
Overassessment		1,441.15	

From a reconsideration and audit of the information and data on file, it is disclosed that no profit was realized in 1916 from the sale of the Andrews and Hitchcock Iron Company stock to the Youngstown Sheet and Tube Company, and, accordingly, the profit as computed by the revenue agent who verified your return has been excluded therefrom. A portion of the receipts from the ore shipments in subsequent years, however, is taxable, the basis of which is set forth in the statement showing the tax adjustment for your 1917, and subsequent years, returns. The adjustments indicated above are taken from the report submitted by the revenue agent and the resulting adjustments operate to further reduce your net income below the statutory exemption.

1917

		1916 rates	1917 rates
Net income reported in original return		$6,854.88	$8,106.18
Dividends reallocated		3,709.88	3,709.88
Balance at 1916 rates		3,145.00	
16 Add:			
Profit on sale of real estate			4,695.00
Ore payments of $9,900.00 received, less return of capital of $3,222.45			6,677.55
Total			23,188.61
Deduct:			
Balance of contributions not claimed			1,424.46
Adjusted total net income at 1917 rates			21,764.15
Cash dividends		$18,195.65	
Personal exemption		1,000.00	
			19,195.65
Subject to 2% normal tax			2,568.50
Additional exemption			2,000.00
Subject to 2% normal tax			568.50
2% normal tax		51.37	
2% " "		11.37	
Surtax, 1917 rates, on $21,764.15		641.13	
Surtax, 1916 rates, on $3,145.00		31.45	
Total tax liability		735.32	
Original assessment, April, 1918	$37.12		
Additional assessment, May, 1918	5.15		
17 Additional assessment, March, 1920, page 9, line 2	1,184.78		
			1,227.05
Overassessment			491.73

You are advised that your taxable income from ore payments has been determined in accordance with the recommendation of the Committee on Appeals and Review. The following depletion schedule has been computed in accordance therewith:

Depletion schedule

Year	Receipts from ore	Tons paid for	Sustained	Depletion allowed	Claimed by omission
1917	$9,900.00	16,500	$3,222.45	$3,222.45	$9,900.00
1918	11,250.00	18,750	3,661.48	3,661.48	11,250.00
1919	28,785.60	47,976	9,478.14	9,478.14	28,785.60
1920	17,421.79	29,036	5,736.35	5,736.35	17,421.79

From the data on file in this office it is disclosed that the cash dividends of $3,057.00, received from the Youngstown Sheet and Tube Company, and $634.88 from the First National Bank of Youngstown, Ohio, were paid from earnings accumulated in 1917, and therefore are taxable in that year's rates.

The pension received of $300.00 has not been included in the taxable income for this year or later years, inasmuch as pensions paid by the United States Government to widows of soldiers, as such, are not taxable income. A profit of $4,695.00 was derived from
18 the sale of 19.43 acres of "Oriole Farm" for $33,800.00, the March 1, 1913, fair market value being determined to be $1,500,000 an acre from the evidence and information set forth in the report of the revenue agent, which profit was not returned by you.

As a result of the increase in the amount of your total net income, the full amount of the contributions of $4,064.65 made by you during 1917, has been allowed instead of $3,389.44, the previous deduction, which was limited to 15% of your total net income.

1918

Net income reported on original return		$26,692.56
Deduct:		
Pension received		300.00
		26,392.56
Add:		
Ore payments received from Youngstown Sheet and Tube Company, $11,250.00, less return of capital thereon of $3,661.48		7,588.52
Adjusted total net income		33,981.08
Less:		
Personal exemption	$1,000.00	
Cash dividends	55,966.50	
		56,966.50
Income subject to normal tax		None.
Surtax on net income		2,387.16
Assessed on original return, May, 1919		1,393.11
Deficiency in tax		994.05

19 The ore receipts from the Youngstown Sheet and Tube Company less the return of capital thereon have been included as income as shown herein under the statement showing the income and tax adjustment for 1917.

1919

Net income reported on original return		$7,146.30
Add:		
Loss reported on sale of Wick Ave. property	$50,025.00	
Loss corrected to	3,125.00	
		46,900.00
Corrected profit disclosed on sale of East Federal Street property	7,727.28	
Profit reported thereon originally	7,767.79	
Decrease		40.51
Corrected profit disclosed on sale of West Federal Street property	6,149.32	
Profit reported thereon originally	5,499.32	
		650.00
Additional interest received		217.50
Cash dividends omitted		7,528.91
Ore receipts of $28,785.60 received from Youngstown Sheet and Tube Company less return of capital thereon of $9,478.14		19,307.46
Total		81,709.66
20 Less: Additional contributions allowed		3,500.03
Adjusted total net income		78,209.63
Less:		
Personal exemption	$1,000.00	
Cash dividends	72,044.80	
		73,944.80
Balance		4,264.83
Subject to 4% normal tax		4,000.00
Subject to 8% normal tax		264.83
4% normal tax		160.00
8% normal tax		21.19
Surtax on net income		14,129.66
Total tax liability		14,310.85
Tax assessed on original return, March, 1920		32.93
Deficiency in tax		14,277.92

The inclusion of the receipts of $28,785.60 in gross income representing your share of the ore payments by the Youngstown Sheet and Tube Company with a deduction therefrom of $9,478.14, representing a return of capital is based on the schedule in the statement following your tax adjustment for 1917.

The addition of $217.50 to gross income representing additional interest received on mortgages; additional cash dividends of
21 $7,528.91 and additional contributions of $3,500.03 are fully explained in the report of the revenue agent. These items were included in the amended return and brief filed by you under date of March 30, 1922.

Careful consideration has been given to the statements and information contained in the brief and the computation of the loss of $3,125.00 from the sale of the residence on Wick Avenue and the profit of $6,149.32 from the sale of the business property on West Federal Street, have been found to be correct. With respect to the

profit derived from the sale of property on East Federal Street, the computation thereon as set forth in your brief has been reviewed carefully and as a result thereof, the cost of $216,000.00 as determined for the purpose of the Federal estate tax has been used instead of $163,090.00, previously indicated in the revenue agent's report. In accordance with the recommendation of the Committee on Appeals and Review, the profit from the sale of the East Federal Street property has been computed on the installment basis, as shown in your brief.

1920

Net income reported on original return		$99,194.82
Add:		
Ore receipts from the Youngstown Sheet and Tube Company of $17,421.79 less return of capital thereon of $5,736.35		11,685.44
		110,880.26
22 Deduct:		
Tax paid at source on tax-free covenant bonds previously included as income	$36.00	
Pension received	300.00	
		336.00
Adjusted total net income		110,544.26
Less:		
Personal exemption	1,000.00	
Cash dividends	85,825.86	
		86,825.86
Balance		23,718.40
Subject to 4% normal tax		4,000.00
Subject to 8% normal tax		19,718.40
4% normal tax		160.00
8% " "		1,576.67
Surtax on net income		28,993.02
Total		30,729.69
Less: 2% normal tax paid at source		36.00
Total tax liability		30,693.69
Tax assessed on original return, April, 1921		23,917.03
Deficiency in tax		6,776.66

23 The inclusion in gross income of the receipts from the Youngstown Sheet and Tube Company representing your share of the ore shipments with a deduction of $5,736.35, representing a return of capital, is based on the explanation of this transaction in the statement following the adjustment of your net income and tax liability for 1917.

In accordance with the provisions of a recent court decision, the amount of $36.00, representing tax paid for you at the source on tax-free convenant bonds, has been eliminated from the taxable net income.

Payment of the deficiency in tax should not be made until a bill is received from the collector of internal revenue for your district and remittance should then be made to him.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district. If the tax in question has not been paid the amount will be abated by the collector. If the tax has been paid, the amount of the overpayment will first be credited against unpaid income tax for another year or years and the balance, if any, will be refunded to you by check of the Treasury Department. It will thus be seen that the overassessments do not indicate the amount which will be credited or refunded since a portion may be an assessment which has been entered but not paid.

The appeal referred to on page 1 refers only to the deficiencies in tax as the revenue act of 1924 does not provide for appeals on overassessments.

24 Now, October 3, 1929, the foregoing petition certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Aug. 4, 1925.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, for answer to the petition of the above-named taxpayer, admits, denies, and avers as follows:

1. Admits the allegations contained in paragraphs 1, 2, and 3 of taxpayer's petition.

2. Avers that the commissioner has not since June 2, 1924 proposed to assess any deficiency for the year 1917.

25 3. Avers that the commissioner has determined that an overassessment was made for the year 1917 as shown by the deficiency letter attached to the petition. For these reasons the commissioner asks that the portion of the petition relating to the year 1917 be stricken therefrom.

4. Admits that the commissioner has included as part of the taxpayer's income the amounts set out in subdivision 1 of paragraph 4 of the petition representing ore payments received from the Youngstown Sheet & Tube Co., less returns of capital thereon. Denies that any error was committed thereby.

5. Admits that the taxpayer received the sums set out in subdivision 2, paragraph 4, of the petition, in connecting with the sale of stock in the Andrews & Hitchcock Iron Company.

6. Admits paragraphs numbered 1, 2, 3, 4, and 5 on page 2, of the petition and paragraph numbered 8 on page 3 of the petition.

7. Avers that the allegations in paragraphs numbered 6 and 7 on page 3 of the petition are incompetent, irrelevant, and immaterial as part of the petition and asks that the said allegations be stricken therefrom.

9. Denies generally and specifically each and every allegation contained in the taxpayer's petition, not hereinbefore admitted, qualified, or denied.

26 Proposition of law

The amounts set out in the petition were properly included as income under the provisions of section 2(a), title 1, of the revenue act of 1917 and section 213(a) of the revenue act of 1918.

Wherefore it is prayed that taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:
L. C. MITCHELL,
Special Attorney, Bureau of Internal Revenue.

Now, October 3, 1929. the foregoing answer certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

A true copy.
Teste:

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

Docket Nos. 5508, 5916, 5917, 5918, 6014, 6436, 6437, 6438, 18202

EDITH ANDREWS LOGAN, ET AL.,[1] PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Promulgated June 14, 1928

Findings of fact and opinion

1. Petitioners sold stock on March 11, 1916, for more than cost and for more than the March 1, 1913, value. A part of the consideration received was a contract providing for future payments as ore was mined. The contents and life of the mine and the annual production were capable of determination. Held, that the contract received had a determinable fair market value at the date of receipt.

[1] The following proceedings were heard with the above and are decided herewith: Henry W. Heedy, Docket No. 5916; William J. Hitchcock, Docket No. 5917; Frank Hitchcock, Docket No. 5918; William M. Andrews, Docket No. 6014; Carrie L. Shaw, Executrix of the Estate of John Shaw, Deceased, Docket Nos. 6436, 6437, and 6438; Julia Andrews Bruce, Docket No. 18202.

2. Deferred payments under the contract were based upon the number of tons mined annually from the Mahoning mine, the mineral content of which was susceptible of accurate determination. Held, that such portion of the deferred payments received during each year as the number of tons mined during such year bears to the total determined content of the mine constitutes a return of principal and that the balance constitutes a receipt of taxable income.

JOHN W. FORD, ESQ.,
MILLARD F. TOMPKINS, ESQ.,
WALTER M. ANDERSON, ESQ.,
For the Petitioners.

L. C. MITCHELL, ESQ.,
For the Respondent.

These proceedings are for the redetermination of deficiencies in income tax as follows:

	Year	Deficiency	Overassessment
Edith Andrews Logan:			
Docket No. 5508			
(Claim filed)	1915		$18.60
Do	1916		1,441.15
Do	1917		491.73
	1918	$994.05	
	1919	14,277.92	
	1920	6,776.66	
		22,048.63	1,951.48
Henry W. Heedy:			
Docket No. 5916	1918	424.38	
	1919	291.67	
	1920	272.21	
		988.26	
William J. Hitchcock:			
Docket No. 5917	1918	7,967.60	
	1919	3,024.06	
	1920	3,144.05	
		14,135.71	
Frank Hitchcock:			
Docket No. 5918	1918	8,483.14	
	1919	4,889.75	
	1920	1,701.20	
		15,074.09	
William M. Andrews:			
Docket No. 6014	1918	135.80	
	1919	77.19	
	1920	46.76	
		259.75	
Carrie L. Shaw, executrix of the estate of John Shaw, deceased:			
Docket Nos. 6436, 6437, 6438	1918	518.60	
	1919	147.47	
	1920	77.25	
		743.32	
Julia Andrews Bruce:			
Docket No. 18302	1918	9,419.61	
	1919	11,285.51	
		20,705.12	

These proceedings were consolidated for hearing and decision. The allegations of error in the several petitions are substantially the same and are that the commissioner erred (1) in adding certain amounts to the net income reported in the returns filed by the petitioners for the years in question, under the general and erroneous description "ore payments received from the Youngstown Sheet & Tube Company less returns of capital thereon," and in adding to net income reported in the returns filed for the taxable years any sums whatever in respect to the transactions so described, and (2) in treating as taxable income for the taxable years any portion of the sums received by the petitioners during those years as part of the sale price of shares of stock in the Andrews & Hitchcock Iron Company, which were sold during the year 1916.

FINDINGS OF FACT

1. The petitioners are all citizens of the United States and residents of Youngstown, Ohio, except Julia Andrews Bruce, who is a resident of Greenwich, Connecticut.

2. Prior to March 1, 1913, and continuously to March 11, 1916, Edith Andrews Logan owned 250 shares, her mother, Louisa
31 Andrews, owned 1,180 shares, Henry W. Heedy, 100 shares, William J. Hitchcock, 1,000 shares; Frank Hitchcock, 1,000 shares; the Cleveland Trust Company, trustee for the three children of U. A. Andrews (of which William M. Andrews was one), 120 shares; and Julia Andrews Bruce, 350 shares, constituting all of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which at all said times mentioned had 4,000 shares of capital stock issued and outstanding.

3. The Andrews & Hitchcock Iron Company at all times between March 1, 1913, and March 11, 1916, owned among other assets a 12 per cent interest in the capital stock of the Mahoning Ore & Steel Company, which controlled under a lease dated April 1, 1895, and running for 97 years after said date, an iron mine located on the Mesaba Range in Minnesota, known as the Mahoning mine.

4. On March 11, 1916, all the stockholders of the Andrews & Hitchcock Iron Company entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, providing for the sale of their stock in the Andrews & Hitchcock Iron Company to the Youngstown Sheet & Tube Company, the material portions of which contract are set forth in the findings of fact in Julia Andrews Bruce and Edith Andrews Logan, executrix, estate of Louisa Andrews, 5 B. T. A., 300. This contract made reference to a written contract dated December 16, 1914, by and between
32 the stockholders of the Mahoning Ore & Steel Company, the material portion of which is also set forth in the findings of fact in Julia Andrews Bruce et al., supra.

5. Under the said contract of March 11, 1916, the Youngstown Sheet & Tube Company paid for all the outstanding stock of the Andrews & Hitchcock Iron Company the sum of two million, two hundred thousand ($2,200,000.00) dollars in cash and further covenanted and agreed to and with the vendors of said stock as additional consideration for the said stock, as follows:

Fourth. It is understood that said the Andrews & Hitchcock Iron Company is the owner of twelve per cent or three hundred sixty (360) shares of the capital stock of the Mahoning Ore & Steel Company, a corporation of the State of Pennsylvania, having a capital stock of three hundred thousand dollars ($300,000.00) divided into three thousand (3,000) shares of the par value of one hundred dollars ($100.00) each, which said Ore and Steel Company is the owner of certain valuable mines for the production of iron ore, and that the said the Andrews & Hitchcock Iron Company, by an agreement in writing in quintuplicate bearing date of December 16th, 1914, is entitled to take each year a full quota of each grade of ore to be produced by said Ore & Steel Company in proportion to
33 the amount of stock owned by or represented for it, as provided for in said agreement, a copy of which is hereto attached and marked "Exhibit A" for the purpose of making the same a part hereof; and for the purpose of fixing the balance of the purchase price to be paid by the Youngstown Company, it is therefore further agreed between said parties as follows to-wit:

That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of ore to which the said the Andrews & Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the terms of said written agreement of December 16, 1914, and shall give the notice provided for in said agreement and will pay or cause to be paid to said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price, each year, on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2240) pounds of iron ore so entitled to be taken for such year, and actually delivered by said Ore & Steel Company, it being understood that if any part of the quota for any year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof.

34 6. The said contract of December 16, 1914, between the stockholders of the Mahoning Ore & Steel Company, which was by reference made part of the said contract of March 11, 1916, contained, among other provisions, the following:

"The tonnage of each grade to be produced annually shall be fixed by the board of directors on or before April 1st, in each year, and

notice of the fixing of said tonnage shall be mailed promptly to each stockholder.

"Each of the interests, as hereinbefore set forth, shall be entitled to take a full quota of each grade to be produced, in proportion to the amount of stock owned by or represented for them, and within fifteen days after receipt of notice referred to in preceding paragraph shall notify in writing the president of said Mahoning Ore & Steel Company, whether or not it elects to take the full quota to which it is entitled. Undesired tonnage, if any, shall be offered pro rata to the other stockholders, and such portion thereof not desired by them can be disposed of by the board of directors by reducing the originally fixed production to the extent of the unaccepted tonnage or in any other manner the board of directors may agree upon.

"The price of ores shall be fixed each year by the board of directors and shall be at or about the cost of production, including all costs, transportation, delivery, handling, etc., to the lower lake ports."

35 7. The Cleveland Trust Company on January 31, 1918, transferred and assigned to William M. Andrews a 40/4000 interest in the then unpaid portion of the sale price of said stock and terminated the trust with respect thereto.

8. On October 29, 1916, Louisa Andrews assigned and transferred to John Shaw, by way of gift inter vivos, an interest of 80/4000 in the then unpaid portion of the sale price of said stock.

9. The value on March 1, 1913, of the shares of stock owned by the petitioners and sold by them under said contract of March 11, 1916, was in excess of the following sums, respectively:

Edith Andrews Logan	250	shares	$173,089.80
Henry W. Heedy	100	"	69,235.93
William J. Hitchcock	1,000	"	692,359.25
Frank Hitchcock	1,000	"	692,359.25
The Cleveland Trust Company, trustee for William M. Andrews	40	"	27,694.37
Julia Andrews Bruce	350	"	244,703.70

10. The value on October 29, 1916, of the 80/4000 interest in the unpaid portion of the sale price of said stock acquired by John Shaw by gift from Louisa Andrews on that date was in excess of $11,388.74.

11. Since the sale of said shares of stock under the contract of March 11, 1916, the petitioners have respectively received the following sums on account of the purchase price of said stock,
36 down to and including the year 1920, the amounts shown for 1916 in each case representing the stockholder's share of $2,200,000 paid in cash under the contract of March 11, 1916:

Edith Andrews Logan	1916	$137,500.00
	1917	9,900.00
	1818	11,250.00
	1919	8,995.50
	1920	5,444.30
Henry W. Heedy	1916	55,000.00
	1917	3,960.00
	1918	4,500.00
	1919	3,598.20
	1920	2,177.73

William J. Hitchcock	1916	$550,000.00
	1917	39,600.00
	1918	45,000.00
	1919	35,982.00
	1920	21,777.25
Frank Hitchcock	1916	550,000.00
	1917	39,600.00
	1918	45,000.00
	1919	35,982.00
	1920	21,777.25
William M. Andrews	1916	22,000.00
	1917	1,584.00
	1918	1,800.00
	1919	1,439.28
	1920	871.09
John Shaw	1917	3,168.00
	1918	3,600.00
	1919	2,878.56
	1920	1,742.18
37 Julia Andrews Bruce	1916	192,500.00
	1917	13,860.00
	1918	15,750.00
	1919	12,593.70

12. The total of the sums received by the several petitioners as the result of the sale of said stock owned by them and sold under the contract of March 11, 1916, down to and including the year 1920, was in each case less than the value on March 1, 1913, of the stock sold and less than the cost thereof, and in the case of John Shaw was less than the value of his interest at the date he acquired it by gift from Louisa Andrews.

13. On March 11, 1917, Louisa Andrews, Julia Andrews Bruce's mother, died, leaving a last will and testament which was duly admitted to probate and under which Julia Andrews Bruce received by bequest a 550/4000 interest in any payments that might subsequently become due under the said contract of March 11, 1916.

14. The value of the said 550/4000 interest so acquired by Julia Andrews Bruce under her mother's will was fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax imposed upon the estate of Louisa Andrews at $277,164.50.

15. Since the death of her mother, Louisa Andrews, on March 22, 1917, Julia Andrews Bruce, down to and including the year 1920, has received the following sums under said contract of March
38 11, 1916, on account of the 550/4000 interest in the future payments under said contract acquired by her under her mother's will:

1919	$19,790.10
1920	11,977.49

16. The total of the sums so received by Julia Andrews Bruce since her mother's death by virtue of the 550/4000 interest in the future payments under the contract of March 11, 1916, acquired by Julia Andrews Bruce under her mother's will was less than the value of the said 550/4000 interest as fixed by the commissioner for the purposes of the Federal estate tax upon the estate of Louisa Andrews and less than the value of said interest at the date it was acquired by inheritance from her mother.

17. The several petitioners, between March 1, 1913, and December 31, 1920, kept no books and their returns for Federal income tax purposes for the years 1916 to 1920, inclusive, were made on the basis of cash receipts and disbursements.

18. On March 11, 1916, the Mahoning Ore & Steel Company's property consisted of approximately 1,000 acres of leased mineral land and at that time between 400 and 500 acres were totally or practically unexplored.

19. Fifty per cent of the stock of the Mahoning Ore & Steel Company in 1916 was held by the Cambria Steel Company and the remainder by other steel companies.

39 20. Until 1909 or 1910 the policy of the Mahoning Ore & Steel Company had been one of conservation, the production running between 1,000,000 and 1,500,000 tons per annum.

21. In 1911, 1912, and 1913, owing to the increasing tax burden and the change of the control of the Cambria Steel Company, the company entered upon extensive stripping operations which placed it in a position to produce 3,000,000 tons a year.

22. Under the agreement of December 16, 1914, the amount of tonnage to be produced annually by the Mahoning mine was left to the determination of the board of directors of that company.

23. A difference of opinion existed between engineers and experts qualified by education and training in the iron mining industry employed by the Mahoning Ore & Steel Company, on the one hand, and by the commissioner, on the other, as to the estimated annual production of the Mahoning mine and its life as of March 11, 1916.

24. Engineers employed by the commissioner estimated that at the date of the contract of March 11, 1916, the ore reserves of the Mahoning Ore & Steel Company were 82,858,535 tons; that the average annual future production from said mine would be 1,841,300 tons; and that the life of the mine was 45 years from March 11, 1916.

40. 25. The estimate mentioned above and adopted by the commissioner as a basis for determining deficiencies in the income tax of the petitioners was based upon data furnished by the engineers of the Mahoning Ore & Steel Company to the respondent to enable him to fix the depletion rate for the Mahoning Ore & Steel Company. It was based upon the content of recoverable ore in only approximately 620 acres out of the entire property leased by the company.

26. Since fixing the deficiency in the case of Edith Andrews Logan, the commissioner in a proceeding in which the depletion rate for the Mahoning Ore & Steel Company was changed, based upon data furnished by the company and the opinions of duly qualified engineers and experts employed by him, found that the life of said mine was 40 years from March 1, 1913, and that the estimated ore reserves of said mine on March 1, 1913, were 88,561,533 tons. The tonnage

mined from the Mahoning mine from March 1, 1913, to March 11, 1916, was 5,039,655 tons.

27. The actual ore in tons mined annually for the Mahoning Ore & Steel Company between 1913 and 1926, inclusive, was as follows:

1913	1,515,428	1920	1,720,537
1914	1,212,287	1921	303,020
1915	2,311,940	1922	1,011,204
1916	2,215,788	1923	3,029,865
1917	2,525,144	1924	1,717,092
1918	2,019,481	1925	1,099,133
1919	1,217,167	1926	1,813,811

28. Assuming that the said Mahoning Mine had ore reserves on March 11, 1916, of 82,858,535 tons, and further assuming that all said ore that would be mined, and 12 per cent thereof, namely, 9,942,564.2 tons, would be delivered to Youngstown Sheet & Tube Company, the total amount which would be received under the provisions of the contract of March 11, 1916, by all the vendors of said stock and their successors in interest would be the sum of $5,965,814.52 at the rate of 60 cents per ton.

29. The present worth of the sum of $5,965,814.52, based upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6 per cent, with provision for a sinking fund at 4 per cent, was on March 11, 1916, $1,942,111.46, which is the value of the contract at March 11, 1916, determined by the commissioner and used by him in computing deficiencies in tax.

OPINION

SMITH: In the petition of Edith Andrews Logan it is stated that "the tax in controversy is income tax for the years 1915 to
42 1920, inclusive, and is more than $10,000, to wit, $22,048.63."

The notice of deficiency attached to the petition shows overassessments for the years 1915, 1916, and 1917, covered by claims filed in the aggregate amount of $1,951.48, and deficiencies in tax for the years 1918, 1919, and 1920 in the aggregate amount of $22,048.63. The pleadings do not present basic facts showing that the board has any jurisdiction to determine the correct tax liabilities for the years 1915, 1916, and 1917, and the petitioner in her brief makes no reference to those years. The appeal is accordingly dismissed in so far as it relates to the years 1915, 1916, and 1917.

The remaining issues presented by these proceedings are the same as those presented in Julia Andrews Bruce, et al., 5 B. T. A., 300, wherein we held that the transaction which took place in 1916 was a completed sale and that the amounts of money received by the petitioners during the tax years under the contract of March 11, 1916, were in part a return of capital and in part taxable income. It was argued before the board in those proceedings, as it is argued by counsel for the present petitioners, that the interest of the petitioners in the contract of March 11, 1916, had no fair market value in 1916 and that, therefore, the transaction was not a closed one and that the

petitioners were not liable to income tax upon moneys received in future years under the contract until they had recovered back the cost or fair market value on March 1, 1913, whichever was higher.

In the opinion we stated:

43 "The petitioners have also raised the point that there was no market value for the contract right received by Julia Andrews Bruce and Louisa Andrews in 1916. The only testimony offered in support of these contentions was by Hitchcock, former president of the Andrews & Hitchcock Iron Company. This witness testified that in the negotiations for the sale of the stock there was no discussion concerning a full cash payment, because the buyer, the Youngstown Sheet & Tube Company could not afford to pay cash in full. This is all the testimony offered in support of the allegation that the contract to receive future payments had no market value."

The present petitioners contend that unlike the Julia Andrews Bruce case, supra, they have offered affirmative proof showing that the contract of March 11, 1916, under which their shares of stock were sold, in so far as the future indeterminate payments were concerned, had no fair market value.

Frank Hitchcock, the president of the Andrews & Hitchcock Iron Company on March 11, 1916, testified at the hearing of the present cases:

"Q. Mr. Hitchcock, at that time, namely, March 11, 1916, did you know of any market where you could have obtained, or did you know of any market where could be sold, an interest of 12% of the stock of the Mahoning Ore & Steel Company?—A. No; not at its value.

44 "Q. Mr. Hitchcock, in 1916, was there any price established by public sale or sales in the way of ordinary business, of similar contracts to this contract of March 11, 1916, by which the fair market value of the contract at that time, at the time it was made, could be determined?—A. No.

"Q. Was there in 1916 any general market for contracts of this character, and any established or current market price?—A. No."

John B. Putman, connected with Pickands, Mather & Company, Cleveland, Ohio, likewise testified that in his opinion there was no fair market for the interests of the several petitioners' in the contract of March 11, 1916; that the vendors on any sale of this contract in 1916 could not have readily realized in cash or its equivalent its real value.

J. C. Agnew, mining engineer who was connected with the Mahoning Ore & Steel Company from 1904 to 1923, testified:

"Q. In 1916, was there any price established by public sales or sales in the way of ordinary business, of similar contracts, by which the fair market value of that contract at the time it was made could be determined?—A. No.

"Q. Was there, in 1916, any general market for contracts of that character, and any published or current market price for the same?—A. Not to my knowledge.

"Q. In your opinion, could the vendors or sellers under that
45 contract, on any sale of the contract, have realized in 1916 in cash or its equivalent its real value?—A. No; I do not think so."

Of the above witness, Hitchcock and Agnew testified before the board in Julia Andrews Bruce, et al., supra. The only additional witness for the petitioners in the present proceedings is John B. Putnam. He did not profess to be an expert on any subject connected with mining and did not claim to have anything more than general information as to any subject connected with these proceedings. He stated that he was generally familiar with iron-ore contracts. He also stated:

"There have been sales of iron ore mines, but I am not familiar with any except in a general way."

Two mining engineers testified for the respondent that in their opinion it was practicable and feasible to estimate both the reserve and probable life of the Mahoning mine. Both of these men were familiar with the property in controversy. One of the engineers had taken part in formulating the commissioner's determination as to the probable life of and as to the tonnage of ore in the mine. He stated that the pit operated by the Mahoning company adjoined another pit known as the Hall Rust mine, on adjoining property, and that the two properties constituted one mine from a physical standpoint and that it was the largest developed iron mine in the
46 United States. The iron is found in a well-defined formation and is one of the best grades of iron ore in the United States. Above the iron ore is the surface of overburden of glacial drift, varying from 5 to 30 feet in thickness. He stated:

"The physical conditions make it feasible to estimate the ore content. You can make a very accurate estimate of it. I would say the degree of accuracy obtained in estimating ore reserves in this property will be much higher than at any other mine that I know of, because of the geographical conditions and the development of the work, the drill work, and the activity of adjacent properties * * *. I do not know of any mining section where it is as easy to make an estimate of ore reserve as it is on the Mesaba."

The stipulation filed in these proceedings shows that the respondent estimated ore reserves and probable life as of 1916 and also as of 1913. The estimate of reserve in 1913 when modified by the ore mined between 1913 and 1916, is within one-half of one per cent of the 1916 estimate. In 1913 probable life was estimated at 40 years and in 1916 at 45 years. On this point one of the engineers for the respondent testified:

"The commissioner's appraisals of 40 years as of March 1, 1913, and 45 years as of March 11, 1916, are very consistent because
47 they were made as of different basic dates. In each case you had a different set of facts on which to base the valuation. In the later appraisal you had additional history of three years to con-

sider. The production for those three years was slightly less than 2,000,000 tons a year and during those three years the demand for iron ore was about the average."

All of the mining engineers who testified before the board agreed that the production of a mine of the character of the Mahoning mine here involved is strongly influenced by the general conditions of business in the country. They were agreed that in times of prosperity the production will be greater than in times of depression. J. C. Agnew, testifying for the petitioners, stated:

"The demand for iron ore bears a very close relation to the general prosperity of the country * * *.

"In estimating the future production of the Mahoning mine as of 1916 the general demand in this country for iron ore would certainly be an important factor. Another important factor would be the condition of the industry in this country, whether times were prosperous or otherwise."

The two government engineers concurred in this view.

Upon the basis of data furnished by the Mahoning Ore & Steel Co., the respondent determined that the ore in place as of March 11, 1916, was 82,858,535 tons. It is in evidence that this
48 estimate did not take into consideration ore, if there was any, in approximately 400 acres of land controlled by the company. No evidence has been adduced before the board that would prove the inaccuracy of the estimate. The doubt, if any exists, is as to the length of time it will take to mine the ore. Upon the basis of data furnished by the Mahoning Co. the respondent estimated that the life of the mine would be 45 years from March 11, 1916, and that the average annual production would be 1,841,300 tons. During the eleven-year period from 1916 to 1926, inclusive, the total production was 19,272,242 tons, or an average annual production of 1,752,000 tons.

The contract which the stockholders of the Andrews & Hitchcock Iron Co. had with the Youngstown Sheet & Tube Co. was that they should receive 60 cents per ton upon their 12 per cent interest in the ore mined from the Mahoning mine. The important question in the case is as to whether that contract had a fair market value as of March 11, 1916. The petitioners contend that they could not have gotten a fair market value for their interests in the contract if they had attempted to sell them. Witnesses for the petitioners believed that the true value of the interest of each of the petitioners was much in excess of what each could have sold it for. This question of belief does not, however, in our opinion satisfactorily establish that the interests had no fair market value. In 1916 it could be fore-
seen that each of the petitioners would receive considerable
49 amounts of money under the contract during the years immediately succeeding 1916. It is hardly probable that persons conversant with the contract would not have given something for the interests of the several petitioners therein. Statements that the contract had no value because in the opinion of certain witnesses the

interests of petitioners therein could not have been sold at their full market value is not satisfactory evidence that they did not have a fair market value.

In support of their contention that the contract of March 11, 1916, had no fair market value in 1916, the petitioners cite the decision of the court in Bourne v. McLaughlin, 19 Fed. (2d), 148. We are of the opinion that that case is readily distinguishable from the cases at bar and is not controlling here. In that case the court expressly stated that the stock could not have been disposed of "except at such a sacrifice as to amount to a virtual donation," and that attempts to sell the stock were unsuccessful. There is no such evidence before the board in the proceedings at bar.

Upon the record made we are of the opinion that the contract received by the petitioners as a part consideration for their holdings in the Andrews & Hitchcock Iron Co. had a determinable fair market value when received by them in 1916. No evidence has been adduced that the determination of the commissioner of the fair market value of the interests of the several petitioners at the basic dates were in error, and in the absence of such evidence the determinations of the respondent of such values are approved.

50 The petitioners' contention that they derived no taxable income from payments made to them during the taxable years because up to the close of 1920 no one of them had received under the contract the admitted value of the property sold either as of March 1, 1913, or March 11, 1916, is very similar to that which was made before the board in Ruth Iron Co. et al., 4 B. T. A., 1151, wherein it appeared that in January, 1913, the petitioners sold certain ore-bearing property and each of them received in exchange for its or his interest therein a certain amount in cash and 41 noninterest-bearing promissory notes, payable annually thereafter, indorsed by the United States Steel Corporation and further secured by a vendor's lien upon the property. Upon the facts presented we held that the amounts received by the petitioners upon the payment of their respective notes in the years 1919, 1920, 1921, and 1922 in excess of the fair market value of such notes on March 1, 1913, which value was in excess of cost, was taxable income. One of the petitioners in that case was Francis S. Kosmerl, and from the adverse decision of the board, appealed the case to the Circuit Court of Appeals for the Seventh Circuit. In an opinion handed down February 18, 1928, the order of the board was affirmed. In the course of the opinion the court stated:

"For petitioner a witness testified generally that at the time the notes were given the ore body was worth more than 35 cents per ton. But the ore at that time was plainly not worth that

51 much to the owners, who had optioned it under the lease at 35 cents a ton, not payable in cash, but as and when it should be mined, over a period which, on January 1, 1913, had yet 41 years to run; so that while the lessee had the right to exhaust the property at 35 cents per ton, this might not, and probably would not,

have been payable until many years after the date when the lease was abandoned and the sale consummated. So it appears that the actual consideration which passed from the owners was not a present 35 cents per ton, but that price over a period up to 41 years thereafter, thus greatly reducing the 35 cents per ton value of the consideration which passed in payment for the notes.

"And so with respect to the notes themselves, which, by their terms, matured up to 40 years from their date, without interest. That the notes were good is quite beyond dispute—good, however, only for their face value at maturity, but surely not good for their face value when made. That a note, however absolutely good the security, due 40 years from its date, without interest, is not worth its face at time of making is apparent from the mere statement. And so with the notes in question, paid in 1921 and 1922, eight and nine years from their date. Conceding these notes to have been capital assets of the taxpayer on their date, they were capital assets not for their face value but for the materially less amount which
52 the notes were then actually worth; and in their payment at maturity there was plainly gain, profit or income to the extent of the difference.

"In Platt v. Bowers, 13 F. (2nd), 951, the court dealt with a very similar situation, and held that while the annually maturing obligations represented capital assets, and were not taxable as gains, profits, or income, yet where the obligations were for serial annual payments without interest, under the acts of 1918 and 1921 there was, upon conversion of the obligations through their payment, profit to the extent of the difference between the value of the obligations on March 1, 1913, and the amount so realized thereon."

The above-referred to case is not an exact parallel to the cases at bar, for there the petitioners parted with a note during each taxable year and received the face value thereof. Here the petitioners parted with shares of stock in Andrews & Hitchcock Iron Company in 1916 for a cash consideration and a contract entitling them to receive an amount per annum to the end of the lease held by the Mahoning Ore & Steel Co. based upon the amount of ore mined during each year. The number of tons of ore in the mine was susceptible of accurate determination and the amount of the ore to be mined annually over a period of years was likewise susceptible of determination. If the difference between the present worth of the noninterest-bearing notes in 1913 in the Kosmerl appeal and the amount received
53 during the taxable year was income of the taxable year we think that the application of the same principle to the proceedings at bar requires the petitioners to return as taxable income a portion of the amount of royalties received each year. This was substantially the decision of the Circuit Court of Appeals, Third Circuit, in Kate W. Rosenberger v. McCaughn, March 3, 1928 (not yet reported). The plaintiff in suing to recover the tax paid on amounts received under a mining lease entered into prior to March

1, 1913, claimed that inasmuch as under the Pennsylvania law the lease was treated as a sale of coal in place, the payments received should be treated as a return of capital. In the course of the opinion the court stated:

"Reverting to the plaintiff's contention that all payments she had received under the instrument here in question were tax free because they were part payments of the purchase price of property sold prior to March 1, 1913, still—always keeping in view the nature of mining, the source of the proceeds—we think each payment represented in some measure both capital and increment, capital because it stood in the place of coal and increment because in the payments running through ninety-nine years interest on the capital must inevitably have been included, and that this increment or interest was a gain "derived" within the generalization of the statutes "from any source whatever" and was income in substantially the
sense of New Creek Coal Company v. Lederer, 295 Fed. 433
54 (4 Am. Fed. Tax. Rep. 3769). The plaintiff can very properly demand that the capital included in her proceeds from mining shall not be taxed. United States v. Ludey, 274 U. S. 295 (6 Am. Fed. Tax Rep. 6754); New Creek Coal Company v. Lederer, supra. But when the capital in the proceeds has been determined and set aside the balance is income and is the very thing on which the government lays its hands and exacts a tax. Stratton's Independence v. Howbert, 231 U. S. 399 (Am. Fed. Tax Rep., 2883); * * *"

See also Florence L. Klein, 6 B. T. A., 617.

At the hearing of these proceedings counsel for the petitioners stated that they desired merely to submit to the board these cases on the sole and particular question whether the 1916 transaction was a closed transaction and that if upon the evidence submitted the board was of the opinion that it was a closed transaction then the deficiencies must be redetermined in accordance with the board's decision in Julia Andrews Bruce, et al., supra, in which the same contract was involved. Counsel for the respondent objected, however, to the redetermination of the deficiencies in accordance with the Julia Andrews Bruce, et al., supra, decision and contended that the deficiencies should be redetermined to be the amounts found by the respondent.

In Julia Andrews Bruce, et al., supra, we held:

"* * * The commissioner in his determination of the
55 deficiency has determined the fair market value of the right to receive future payments, and from the evidence presented we can not say that his determination is not correct. A portion of each payment under the contract was a return of capital and a portion represented gain. The commissioner has determined what portion is gain by dividing the 1916 value of the contract by the total tonnage to be obtained, reaching the conclusion that the payment for each ton represents 19.53 cents return of principal and 40.47 cents income,

or, in other words, that each payment, whether made one year after the agreement was made or 45 years thereafter, is made up 35.554 per cent return of principal and 67.446 per cent income.

"The payments to all the stockholders were estimated by the commissioner to be $132,573.60 annually for 45 years. These payments were reduced to present worth, using a discount of 6 per cent on future payments with a 4 per cent return on sinking fund. It is evident that the present worth of the payment to be received at the end of the first year differs substantially from the present worth of the payment to be received 45 years in the future. It is further evident that the present worth of all of the payments is the sum of the present worth of each annual payment, proper adjustment for the sinking fund being made. In determining what portion of the payment represented a return of the 1916 value, the commissioner has made the allocation between principal and gain
56 as if the present value in 1916 of each of the annual payments to be received was exactly the same. * * *"

Our question now is whether we were correct in reaching the above conclusion. It will be noted from the foregoing that for the purpose of determining the amount of income received by each petitioner from the royalty payments, the commissioner considered that of each royalty payment received a part represented a return of the value of the contract on April 11, 1916, and the balance represented income. The amount of each royalty payment which represented a return of capital was determined by dividing the fair market value of the contract on April 11, 1916, by the estimated tons of ore in the mine on that date. The difference between the royalty payment of 60 cents and the foregoing amount was taken as the income received on account of each ton of ore mined. The income for a given year was obtained by multiplying the unit of income for a single ton of ore by the total number of tons mined in a given year. The board rejected the respondent's basis and held that—

"The proper manner in which to determine what portion of the payment is principal is to split up the total 1916 present worth into its component parts and to treat the present value of the first year's payment as a return of principal upon the first 1,841,300 tons (the estimated annual production) mined, the present value of the
57 second year's payment as a return of principal upon the second 1,841,300 tons mined, and similarly each year until the mine becomes exhausted, or the principal is all returned."

In this manner the greater part of the amounts received in the first years would represent a return of principal and a small part income, whereas during the last years of the existence of the contract the reverse situation would be true regardless of the income produced by the contract in the various years. For example, under this theory, the amount to be accounted for each year would be $1,064,600, and in the first year approximately 94 per cent would be considered a return of principal and approximately 6 per cent income, whereas in the

forty-fifth year approximately 6 per cent would represent a return of principal and approximately 94 per cent would represent income.

Does the foregoing decision of the board afford a reasonable basis for the determination of the amount of income of the petitioners from the royalty payments received? It is believed that this question may best be answered by keeping in mind the nature of the asset received when the 1916 transaction was effected. What happened in 1916 was that certain stock was sold for $2,200,000 and a contract which the respondent determined had a fair market value at date of receipt of $1,942,111.46, which value we have approved for lack of evidence showing error on the part of the respondent in making such determination. The contract in question was an income-pro-
58 ducing asset in that under its terms the owners thereof were entitled to receive income to the extent of 60 cents a ton on a certain part of the ore that was to be mined and the contract was exhaustible in that it had a value only so long as there remained ore to be mined.

The board is of the opinion that a proper solution to the question of what part of the royalties received constituted taxable income lies in considering the entire amount of royalties received in a given year as includable in gross income and then in permitting a reasonable deduction therefrom in each year for the exhaustion of the contract. Section 213 (a), revenue act of 1918, provides in part that gross income—

"Includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer * * *"

We can not escape the conclusion that the foregoing provision would require all royalties received to be included in the gross income of the recipients. But all of the amounts received would not be subject to tax for the reason that in the production of this
59 income, the asset which produced this income was gradually being exhausted and Congress provided in section 214 (a) (8), revenue act of 1918, that there shall be allowed as a deduction from gross income "A reasonable allowance for the exhaustion * * * of property * * *." No one would seriously question that a contract is property, and we think it equally clear that the contract in question is property which is being exhausted in the production of income and, consequently, that a deduction on account thereof is justified under the foregoing provision of the statute. See Lynch v. Alworth-Stephens Co., 267 U. S. 364. The difference between the royalties received and the allowance for exhaustion would constitute gain derived from capital which would satisfy the classic definition

of income as laid down in Stratton's Independence v. Howbert, 231 U. S. 399, and since often reiterated, to the effect that income is the "gain derived from capital, from labor, or from both combined." Here the gain is derived from capital, which capital is in the form of a contract which was received in part payment for stock which was sold and which will be productive of income until exhausted.

Our next question is what constitutes a reasonable allowance for the exhaustion of the contract. Since the value attaching to the contract is on account of royalties to be received as the ore is mined, we are of the opinion that a reasonable allowance in each year is determinable upon the basis of the ore mined. It is true that we are not here seeking to determine depletion in the case of a
60 mine, yet the relationship between the exhaustion of the mine and the exhaustion of the contract are such that we think the same principles would be applicable in each case. The method for computing the deduction for the depletion of mineral deposits, as set out by the commissioner in his regulations, is on the basis of the annual production. Article 210 (b), Regulations 45, provides:

"When the value of the property at the basic date has been determined, depletion for the taxable year shall be determined by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold within the taxable year. * * *"

See also articles 201, 202, 203, and 204 of the same regulations. In New Creek Co. v. Lederer (C. C. A.), 295 Fed. 433, the court had before it the question of the reasonableness of the commissioner's regulations with respect to depletion under the revenue act of 1916, which embody the same principle which appears in the aforementioned regulations (in so far as material to this discussion), the Government there contending that—

"Royalties represented both capital and income and that the allowance for capital depletion which the statute authorized was to be determined by the value in the ground of each ton of
61 coal on March 1, 1913, * * * multiplied by the number of tons mined in the year for which the tax was payable."

In approving the commissioner's regulations as providing a reasonable depletion allowance, the court said:

"* * * On the theory of the statute, as we read it, depletion allowance was intended as a return to the taxpayer of the original cost of the coal so that he may be taxed not on the whole of its sale price in the event that he is an operating owner, or on the full amount of royalties if he is a lessor, but that he may be taxed on the difference between the cost (capital) and the sale price or royalties received (income). (Of course in estimating income on sale price other factors enter.) If he were allowed to deduct in each year the full amount of the sale price or the full amount of the royalties received (as the plaintiff here claims), the practical effect would be

that he would, for many years, pay no tax at all, and this regardless of the fact that the total sale price (or total royalties) may, ton by ton, show a profit over the original capital cost. It is this profit or net income annually earned which the act taxed annually. And in this regard we see no distinction in the application of the principle to a mine owner whose income is royalties and to a mine owner whose income is derived from working the mines and selling the
62 coal. The only difference is that in the latter more factors enter into the calculation. The principle is the same.

"We do not find that the rules and regulations prescribed by the Secretary of the Treasury for the enforcement of the allowance for depletion under the provisions of the revenue act of 1916 are, in view of the subject matter of taxation, unreasonable, or that by these rules the taxable was deprived of the deduction which the statute allowed."

Likewise, in Lynch v. Alworth-Stephens Co., supra, where it was held that a lessee of a mine is entitled to an allowance for depletion, the court said:

"It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent does not own the ore deposits, its right to mine and remove the ore and reduce it to posesssion and ownership is property within the meaning of the general provision. Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same
63 mines is likewise lessened. There is an exhaustion of property in the one case as in the other; and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered."

The board is convinced that the foregoing principles which were considered applicable in determining a reasonable allowance for the depletion of a mine would apply with equal force in determining the reasonable allowance for the exhaustion of a contract which is dependent for its value upon the right to receive a royalty upon the content of a mine as the ore is mined and which value will be reduced or exhausted as the ore is taken from the ground.

While in the instant case the respondent divided the royalties received as between a return of capital and income, the result reached is the same as if the entire royalties received had been included in gross income and an allowance for exhaustion of the contract treated as a deduction from this gross income. In fact, the end sought in an exhaustion allowance is to have the capital sum invested in a

wasting asset returned to the taxpayer as a charge against income earned by the asset and in this way avoid taxing a return of capital. The entire income earned is not taxable, but only so much thereof as does not represent a return of capital. The return
64 of capital is represented in the case at bar by the exhaustion allowance, which, when deducted from the total royalties received, will produce the same amount of taxable income as determined by the respondent. See the Royal Collieries Company, 1 B. T. A. 369. The action of the respondent is accordingly sustained.

In the instant proceedings we are not attempting to lay down a rule for the determination of a reasonable amount for depletion in the case of a mine. Nor do we attempt to determine what would be a reasonable allowance for the exhaustion of a contract where the facts are substantially different from those which obtain in the instant proceedings. All that we do determine is that the method invoked by the respondent of computing the income from the contract is reasonable and should be sustained in the absence of evidence of error on the part of the respondent in making such determination.

The foregoing principles as to the manner in which income from the contract shall be reported are, of course, inconsistent with the method approved by the board in Julia Andrews Bruce, et al., supra, in that under the Bruce case, neither the income to be reported nor the allowance for exhaustion bear any necessary relation to the income received in a given year, nor to the extent to which exhaustion has been suffered in the production of this income. It is true that in the valuation of this contract we have based our conclusion as to the fair market value upon the basis of the present worth of the royalties which it was estimated would be received over the life
65 of the contract, but because we followed this method of valuation does not mean that where, for example, the same tonnage of ore was mined in the first year and in the last year of the existence of the contract the greater part of the royalties in one case would be capital and in the other case, income. The net income in each case would be the same. The value which we arrived at was such a value as we considered would have resulted had the contract been offered for sale by a person willing to sell and had been acquired by a person willing to buy. In effect, the method followed and the result reached is not essentially different from that in the case of the valuation of a leasehold at March 1, 1913. In such case a value is often assigned to the leasehold for the reason that had it been necessary to renew the lease on that date, the rental to be paid would have been greater than was being paid under the terms of the lease negotiated prior to March 1, 1913, and, consequently, we say that there will be a saving over the remaining life of the lease of the difference between the two rental amounts, which reflects a March 1, 1913, value of the leasehold. Even though such value may be arrived at on the basis of the present worth of the savings over the period of years, we have never heard it contended that the deduction allowable in a given year

on account of the exhaustion of such a leasehold value should bear any relation to the present worth value of the saving for such year. The basis for exhaustion of such a leasehold which has been recognized repeatedly by the board and the courts is either a time
66 or production basis depending upon the nature of the asset, and that, regardless of the fact that in determining the March 1, 1913, value, the value of the saving for the first year would be greater than for any succeeding year. We do not conceive that the situation with respect to the exhaustion of the contract in question would have been different had the valuation which we arrived at been upon the basis of an offer to buy the contract rather than the present worth method. An offer to buy would necessarily have been predicated upon the profits to be realized from the contract and the profits which were expected to be realized one year hence would have been a greater present value than the profits which were expected to be realized forty-five years from that time, yet had the valuation been fixed on such an offer, it is hardly to be supposed that it would be seriously contended that the income to be reported and the exhaustion to be allowed would bear any relationship to such values. To the extent, therefore, that the opinion in Julia Andrews Bruce, et al., supra, is in conflict with the views hereinbefore expressed, the same is overruled.

Reviewed by the board.

Judgments will be entered for the respondent.

Dissenting opinion

PHILLIPS, dissenting in part: The difficulty I encounter in the present case is in reconciling the method by which the capital value of the contract is determined with the method by which the
67 capital returned by each payment is computed. In valuing the contract a method is used which recognizes that payments to be received in the future must be discounted to their present value. (Findings 28 and 29.) Upon this basis it is recognized that the right to receive royalties from the ores to be mined in the first year of operations is much more valuable than the right to receive royalty from an equal number of tons of ores to be mined several years later. The value of the contract is determined to be the sum of the present value of these future payments. (Findings 29.) In this manner the value of the contract is determined by assigning a capital value to the royalty upon each ton of ore to be mined in the future, a greater capital value per ton being assigned to the royalty from the first ore mined than to the royalty from the ore which is mined later. It seems to me that if we are to use this method of determining the capital value of the contract, we are not justified in departing from it when the royalties are received and we are called upon to determine what portion of the amount received from each ton mined represents capital value.

The rule adopted by the commissioner and followed by the board by which a uniform value is assigned to the royalty right in each ton of ore, whether mined in the first year or the last year of operations, may be proper in a large majority of cases, but it seems to me that it cannot properly be applied where, as here, in determining the capital value of the contract, capital values have been
68 assigned to the right to receive royalties on these ores which vary according to the time when the ores will be mined. It is my opinion that in such a case the petitioners have received income only to the extent that the royalties received in the taxable years exceed what has been determined to be the present value, at the time the contract was made, of the right to receive the royalties on an equal number of tons of ore. The computation of income upon this basis is no more difficult than the computation of the present worth of the right to receive royalties; it requires, in fact, nothing more than the use of the same tables used in the computation of value.

This principle has received the sanction of the courts in Hull v. McHale (United States District Court for the Eastern Division of the Northern District of Illinois), not reported, which was affirmed by the Circuit Court of Appeals for the Seventh Circuit in McHale v. Hull, 16 Fed. (2nd) 781, and followed in Spalding v. Reinicke, not reported, which arose in the same district.

TRAMMELL agrees with this dissent.

Now, October 3, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

B. D. GAMBLE,
[SEAL.] *Clerk, U. S. Board of Tax Appeals.*

69 Before United States Board of Tax Appeals

Washington

Docket No. 5508

EDITH ANDREWS LOGAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order of redetermination

Pursuant to the board's findings of fact and opinion, promulgated June 14, 1928, it is

Ordered and decided: That, upon redetermination, there are deficiencies as follows:

1918	$994.05
1919	14,277.92
1920	6,776.66

The proceeding insofar as it relates to the years 1915, 1916, and 1917 is dismissed for lack of jurisdiction.

(S.) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

Dated Washington, D. C.

70 Enter:

Entered June 15, 1928.

A true copy.

Teste:

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, October 3, 1929, the foregoing order of redetermination certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Stipulation as to court of review

Filed Dec. 13, 1928

It is hereby stipulated and agreed by and between the parties to the above-entitled cause, by their respective attorneys, that
71 the decision of the United States Board of Tax Appeals in said cause, dated June 15, 1928, and redetermining deficiencies in income taxes against the above-named petitioner for the calendar years 1918, 1919, and 1920, in the amounts of $994.05, $14,277.92, and $6,776.66, respectively, may be reviewed by the United States Circuit Court of Appeals for the Second Circuit.

This agrement is made under and pursuant to the provisions of section 1002(d) of the revenue act of 1926.

MILLARD F. TOMPKINS,
E. H. MCDERMOTT,
JOHN ENRIETTO,
Attorneys for Petitioner.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

Dated this 12th day of December, A. D. 1928.

Now, October 3, 1929, the foregoing stipulation certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE.
Clerk, U. S. Board of Tax Appeals.

72 Before United States Board of Tax Appeals

[Title omitted.]

Petition for review

Filed Dec. 13, 1928.

To the Honorable the JUDGES OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT:

Your petitioner, Edith Andrews Logan, respectfully shows:

I. JURISDICTION FOR REVIEW

This is a proceeding for review by the United States Circuit Court of Appeals for the Second Circuit of a decision of the United States Board of Tax Appeals entered on the 15th day of June, 1928, and redetermining deficiences in income taxes against your petitioner for the calendar years 1918, 1919, and 1920 in the amounts of $994.05, $14,277.92, and $6,776.66, respectively.

Your petitioner at the time of filing this petition is and for a considerable time prior thereto was a citizen of the United States
73 and an inhabitant of New York City, New York. On the 12th day of December, 1928, counsel for petitioner and counsel for respondent entered into an agreement, under and pursuant to the provisions of section 1002(d) of the revenue act of 1926, that said decision of the United States Board of Tax Appeals may be reviewed by this court.

II. NATURE OF CONTROVERSY

The controversy before the United States Board of Tax Appeals concerned the propriety of the action of the Commissioner of Internal Revenue in treating as taxable income for the years in question any portion of the sums received by petitioner during those years as part of the sale price of shares of stock in the Andrews & Hitchcock Iron Company, which were sold during the year 1916 under the following circumstances:

Prior to March 1, 1913, and continuously to March 11, 1916, petitioner owned 250 shares and her mother, Louisa Andrews, owned 1,180 shares of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which at all times mentioned had 4,000 shares of capital stock issued and outstanding. Said Andrews & Hitchcock Iron Company at all times between March 1, 1913, and March 11, 1916, owned, among other assets, twelve per centum (12%) of the capital stock of the Mahoning Ore & Steel Company, a Pennsylvania corporation, which held under lease dated April 1, 1895, and running for 97 years after said date, certain mineral lands in the Mesaba Range of Minnesota.

74 Under a certain contract of December 16, 1914, between the stockholders of said Mahoning Ore & Steel Company, in-

cluding said Andrews & Hitchcock Iron Company, said stockholders agreed in substance (1) that the board of directors should fix on or before April 1, of each year, the annual tonnage of iron ore to be produced; (2) that each stockholder should be entitled to take a full quota of each grade of iron ore to be produced annually in proportion to the amount of stock owned by him; (3) that the price of said ore should be fixed each year by the board of directors at or about the cost of producing, including all costs, transportation, delivery, etc., to the lower lake ports.

On March 11, 1916, all of the stockholders of said Andrews & Hitchcock Iron Company, including petitioner, and her mother, Louisa Andrews, entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, to transfer to said corporation all of the shares of capital stock held by them in said Andrews & Hitchcock Iron Company. The contract of March 11, 1916 incorporated by reference the provisions of the contract of December 16, 1914, above mentioned. In consideration for said transfer, said Youngstown Sheet & Tube Company paid for the benefit of the stockholders of said Andrews & Hitchcock Iron Company $2,200,000 in cash on or before April 11, 1916, and further, by way of additional consideration for said transfer and as the balance of said purchase price covenanted and agreed to pay
75 to the Dollar Savings & Trust Company of Youngstown, Ohio, for the benefit of said stockholders of the Andrews & Hitchcock Iron Company each following year, on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) for each and every ton of 2,240 pounds of iron ore which it might be entitled to take from the Mahoning Ore & Steel Company, and actually delivered by said company. On March 22, 1917, petitioner received by bequest from her mother, Louisa Andrews, a 550/4000ths interest in any payments that might subsequently become due under the contract of March 11, 1916. This interest was valued for purposes of Federal estate taxes imposed on the estate of Louisa Andrews, at $277,164.50.

The value, on March 1, 1913, of the 250 shares of stock of the Andrews & Hitchcock Iron Company, owned by petitioner and sold by her by said contract of March 11, 1916, was greater than cost and was also greatly in excess of $173,089.80, which is the aggregate amount received by petitioner over the period down to and including the year 1920:

1916 (petitioner's share of $2,200,000 paid in cash under contract of March 11, 1916)	$137,500.00
1917	9,900.00
1918	11,250.00
1919	8,995.50
1920	5,444.30
Total	173,089.80

76 Petitioner, prior to and including the year 1920, has received the following sums under said contract, on account of the 550/4000ths interest in the future payments under said contract, acquired by her by bequest:

1919	$19,790.10
1920	11,977.49
Total	31,767.59

The total of the sums so received by petitioner since her mother's death was less than the value of the said 550/4000ths interest as fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax upon the estate of Louisa Andrews, and less than the value of said interest at the date of acquisition by petitioner.

The petitioner, between March 1, 1913, and December 31, 1920, kept no books and made her returns for Federal income tax purposes for the years 1916 to 1920, inclusive, upon the basis of cash receipts and disbursements.

Petitioner determined that the consideration to be paid by the Youngstown Sheet & Tube Company under the contract of March 11, 1916 (hereinafter referred to as "the obligation of the Youngstown Company"), had no present fair market value. In her income tax returns, petitioner treated all receipts from said contract during the years in question as constituting first a nontaxable return of capital. Since the total receipts of petitioner in and prior to the year 1920 were much less than the capital which petitioner
77 was entitled to have returned she reported no part of said receipts as taxable income.

The Commissioner of Internal Revenue treated the obligation of the Youngstown Company as having a fair market value in 1916 and purported to determine that value at $1,942,111.46. He further determined that petitioner was not entitled to have her capital returned fully before realization of income, but that a certain portion of each payment received by petitioner from said Youngstown Company represented a return of capital and the remainder represented a realization of income. Accordingly, he determined that petitioner realized income from the payments during the years in question as follows:

1918	$7,588.52
1919	19,307.46
1920	11,685.44

These were the final determinations, and he proposed the additional taxes now in controversy against petitioner in consequence of such determinations.

Upon appeal to the United States Board of Tax Appeals the final administrative agency in the executive branch of the Government, said board affirmed the action of the Commissioner of Internal Revenue.

The sole question here is whether the action of the board was proper under the law and the evidence.

78 III. ASSIGNMENT OF ERRORS

In affirming the action of the Commissioner of Internal Revenue and in purporting to find and determine a fair market value for the obligation of the Youngstown Company, and in determining that a certain proportion, to wit, 32.554% of each payment received by petitioner represented a return of capital and the remainder, to wit, 67.446% represented taxable income, the United States Board of Tax Appeals committed the following errors, upon which petitioner relies as the basis of this proceeding.

ERRORS IN FAILING TO MAKE FINDINGS OF FACTS REQUESTED

(1) Said board erred in that it failed to find that the obligation of the Youngstown Company to make future payments under said contract of March 11, 1916, had no fair market value at the time said contract was made, though requested to so find and though the fact was material and fully established by evidence.

(2) Said board erred in that it failed to find that said obligation of the Youngstown Company was not substantially the equivalent of cash and/or was not readily convertible into cash in the year 1916, though requested to so find and though such facts were material and fully established by evidence.

(3) Said board erred in that it failed to find that in 1916
79 there was no price established by public sales or sales in the way of ordinary business, of contracts reasonably similar to the contract of March 11, 1916, by which the fair market value of the obligation of the Youngstown Company at the time and place indicated could be determined; that, in 1916, there was no general market for obligations of the character here involved, and no established or current price for such obligations. The board was requested to so find and failed to do so, though such facts were material and fully established by evidence.

(4) Said board erred in that it failed to find that, in 1916, the vendors under the contract of March 11, 1916, on any sale or transfer of their interests thereunder could not have realized in cash or its equivalent, the real value or substantially the real value of said interests though, requested to so find and though such facts were material and fully established by evidence.

(5) Said board erred in that it failed to find that on March 11, 1916, approximately 240 acres, out of the 1,000 acres, of mineral land, leased by the Mahoning Ore & Steel Company were being actively operated, though requested to so find and though such fact was material and fully established by evidence.

(6) Said board erred in that it failed to find that the annual production from the properties leased by the Mahoning Ore & Steel Company would necessarily vary from year to year based upon con-

ditions in the steel business and upon the needs and require-
80 ments of the majority stockholders of said Mahoning Company for the ore produced by that company, though requested to so find and though such facts were material and fully established by evidence.

(7) Said board erred in that it failed to find that it was impossible in 1916 to determine with reasonable certainty the future annual production of the Mahoning Ore & Steel Company, though requested to so find and though such fact was material and fully established by evidence.

ERRORS IN FAILURE TO MAKE WRITTEN FINDINGS OF FACTS ON WHICH BOARD RELIED IN THE DETERMINATION OF DEFICIENCIES

(8) Said board erred in that it failed to make and to include in its written findings of fact a specific finding on whether or not the obligation of the Youngstown Company under the contract of March 11, 1916, had a fair market value at that date, such finding being necessary to a decision of the question before said board, and said board being required by law to make such specific written finding of fact.

(9) Said board erred in that it failed to make and to include in its written findings of fact a specific finding as to the alleged present market value in dollars at March 11, 1916, of said obligation of the Youngstown Company, such finding being necessary to a decision of the question before the board, and the board being required by law to make such specific written finding of fact.

81 (10) Said board erred in that it failed to make and to include in its written findings of fact a specific finding of the respective proportions of return of capital and taxable income held by it to be represented by each payment made to petitioner by the Youngstown Sheet & Tube Company under said contract of March 11, 1916, such finding being necessary to a decision of the question before said board, and said board being required by law to make such specific finding of fact.

(11) Said board erred in that it failed to make and to include in its written findings of fact a specific finding of the recoverable ore content of the lands leased by the Mahoning Ore & Steel Company and of the life of said deposits, upon which factors said board purported to predicate its value of the obligation of the Youngstown Company under the contract of March 11, 1916, though such factors were required to be determined under the method pursued by the board in purporting to determine the value of said obligation, and the board being required by law to make such specific written findings of fact.

ERRORS IN STATING FACTS AND EVIDENCE RELIED UPON BY THE BOARD IN ITS OPINION DECIDING THE CAUSE

(12) Said board erred in assuming and relying on the assumption that it could determine with reasonable accuracy the future

annual production of the Mahoning Ore & Steel Company, in
82 tons, when in fact such production was determinable only at will of the directors of that company.

(13) Said board erred in stating in its opinion and relying upon said statement in deciding the issue, that no evidence had been adduced before the board to prove the inaccuracy of the commissioner's estimate of 82,858,535 tons of ore as of March 1, 1916, the evidence clearly establishing the inaccuracy of said estimate.

(14) The said board erred in assuming and relying on the assumption that the commissioner's determination made in fixing the deficiencies in this case, that the life of the mine owned by the Mahoning Ore & Steel Company was 45 years from March 11, 1916, was correct, when the undisputed evidence shows that since fixing the deficiencies in this case the commissioner in a proceeding to fix the depletion rate of the Mahoning Ore & Steel Company found that the life of said mine was 40 years from March 1, 1913.

(15) Said board erred in stating in its opinion and relying thereon that "in 1916 it could be foreseen that each of petitioners would receive considerable amounts of money under the contract during the years immediately succeeding 1916," said statement not being supported by a finding of fact and being contrary to the evidence adduced before the board.

83 (16) Said board erred in stating in its opinion that the obligation of the Youngstown Company had a definite present fair market value, said statement not being supported by a finding of fact and being contrary to the evidence adduced before the board.

(17) Said board erred in stating in its opinion that there was no evidence before the board to show that the obligation of the Youngstown Company could not have been disposed of except at a substantial sacrifice, evidence having been adduced by petitioner clearly establishing that said obligations could not have been sold except at such a sacrifice.

(18) Said board erred in stating in its opinion (12 B. T. A. 601) that "What happened in 1916 was that certain stock was sold for $2,200,000 and a contract which the respondent determined had a fair market value at date of receipt of $1,842,111.46, which value we have approved for lack of evidence showing error on the part of the respondent in making such determination," said board having made no finding of the market value of said contract and the evidence before said board clearly establishing that no fair market value could be determined for the obligation of the Youngstown Company under said contract.

84 ERRORS IN ADMISSION OF EVIDENCE

(19) Said board erred in admitting in evidence any testimony and statements of facts tending to show the estimate of the ore content of lands leased by the Mahoning Ore & Steel Company and the average annual future production from said lands and the esti-

mated life of the mineral content of said lands from March 11, 1916, said evidence being incompetent, irrelevant and immaterial on the question of the present fair market value in 1916 of the obligation of the Youngstown Company under the contract of March 11, 1916, and said evidence having been duly objected to by the attorney for petitioner.

(20) Said board erred in admitting in evidence testimony and statements of facts that the present worth of the sum of $5,965,814.52, discounted at 6%, with provision for sinking fund at 4% over 45 years, was on March 11, 1916, $1,942,111.46, said evidence being irrelevant and immaterial, since the evidence shows that the estimate of $5,965,814.52 would not be received in equal annual installments over a period of 45 years, and said evidence having been duly objected to by the attorney for the petitioner.

(21) Said board erred in admitting in evidence testimony with respect to whether or not there was a possible market for iron ore mines in the Mesaba Range of Minnesota, said evidence being incompetent, irrelevant, and immaterial on the question of whether or not the obligation of the Youngstown Company had a
85 present fair market value in 1916, and said evidence having been dul yobjected to by the attorney for petitioner.

ERRORS IN CONCLUSION OF LAW

(22) Said board erred in holding that the opinions of expert witnesses and the other evidence before the board were insufficient to establish that the obligation of the Youngstown Company had no fair market value on March 11, 1916, said evidence being fully competent to establish that fact and said evidence being uncontradicted and fully establishing that fact.

(23) Said board erred in treating the payments made by the Youngstown Sheet & Tube Company under the contract of March 11, 1916, as royalties, when in fact, such payments constituted the purchase price of stock, and in determining the taxable income to petitioner under said contract by making allowance for depletion of the contract, it fully appearing from the evidence that such payments were not royalties and should not have been so treated.

(24) Said board erred in determining that of the payments received by petitioner as follows:

1918	$11,250.00
1919	28,785.60
1920	17,129.74

86 the following, or any part thereof, represented taxable net income:

1918	$7,588.52
1919	19,307.46
1920	11,685.44

(25) Said board erred in its method of determining the income of petitioner from the payments made by the Youngstown Company under said contract, in that said board failed to allow to petitioner a return of the cost or March 1, 1913, value, and other basis as provided by law before determining the taxable net income of petitioner, it appearing that said board simply treated said payments as payments of royalties.

(26) Said board should have held that petitioner was entitled under the sixteenth amendment to the Constitution and the revenue act of 1918 to recover the cost or other basis to her of the obligation of the Yongstown Company under the contract of March 11, 1916, before she should be deemed to have realized income from any payments to her pursuant to that obligation.

(27) Said board erred in holding that the contract of March 11, 1916, represented a closed transaction in that year, from which petitioner realized taxable income in that and subsequent years.

(28) Said board erred in that it treated the contract of
87 March 11, 1916, as a gain or loss transaction in that year, as above mentioned, and at the same time it refused to allow plaintiff to recover the value of property determined by the board to have been received by her, before taxing petitioner further with respect to that property.

(29) Said board erred in that in determining the capital value of the obligation of the Youngstown Company, under the contract of March 11, 1916, it had assigned different capital values to the right to receive payments on these ores, varying according to the time when the ores would be mined, but that the board abandoned these values and adopted a uniform value for each payment when it came to determine the amount which should be considered a return of capital on each payment as and when the payments were made.

(30) Said board erred in concluding, in view of the fact that petitioner was properly reporting income on the cash receipts and disbursements basis, that a non-negotiable agreement of the kind here involved for the contingent future payment of cash, gave rise to taxable income or constituted a taxable closed transaction prior to the time income was received by petitioner in cash.

(31) Said board erred in failing and refusing to give effect to the finding that petitioner reported its income on the cash receipts
88 and disbursements basis and in this proceeding confused said petitioner with the petitioners who make returns of income upon the accrual basis of accounting.

Wherefore your petitioner prays that this court may review the determination of the United States Board of Tax Appeals in this cause and reverse the decision of said board because of the errors aforesaid, and direct said board to redetermine the deficiencies against your petitioner on the basis that the obligation of the Youngstown Sheet & Tube Company under the contract of March

11, 1916, had no fair market value on that date; and/or that this court may direct and grant such other and further relief as to it may appear proper in the premises.

MILLARD F. TOMPKINS,
Attorney for Petitioner,
30 Broad Street, New York City.

STATE OF NEW YORK,
County of New York, ss.:
Duly sworn to by Millard F. Tompkins. Jurat omitted in printing.

89 Now, October 3, 1929, the foregoing petition for review certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

90 Before United States Board of Tax Appeals

Docket No. 5508

EDITH ANDREWS LOGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Statement of evidence

Filed Sept. 30, 1929

The above cause came on for hearing before the Honorable Charles P. Smith, member of the United States Board of Tax Appeals, upon the 17th day of January, 1928, there being present petitioners by their counsel, Mr. Tompkins, Mr. Ford, and Mr. Anderson, and respondent by his attorney, Mr. Mitchell.

The above cause at said hearing was consolidated for purposes of hearing and decision with the following cases then pending before the Board of Tax Appeals:

Henry W. Heedy	Docket No.	5916
William J. Hitchcock	" "	5917
Frank Hitchcock	" "	5918
William M. Andrews	" "	6014
Carrie L. Shaw, executrix	" "	6436, 6437, 6438
Julia Andrews Bruce	" "	18202

Thereupon, there was filed with the board the following agreed statement of facts. By agreement of the parties, the same was received in evidence and made a part of this record.

91 AGREED STATEMENT OF FACTS

It is hereby stipulated and agreed by and between counsel for the taxpayer appellant and the Commissioner of Internal Revenue in

the above-entitled case that for the purpose of the hearing of said case the following facts shall be taken as true without the necessity of introducing evidence, subject, however, to the right of either party to raise the question of the materiality of any facts so stipulated.

1. Prior to March 1, 1913, and continuously to March 11, 1916, the taxpayer appellant owned 250 shares, and her mother, Louisa Andrews, owned 1,180 shares, of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which at all said times mentioned, had 4,000 shares of capital stock issued and outstanding.

2. The Andrews & Hitchcock Iron Company at all times between the first day of March, 1913, and the 11th day of March, 1916, owned, among other assets, a 12% interest in the capital stock of the Mahoning Ore & Steel Company which controlled, under a lease dated April 1, 1895, and running for 97 years after said date, an iron mine located on the Mesaba Range in Minnesota, known as the Mahoning mine.

3. On the 11th day of March, 1916, all the stockholders of the Andrews & Hitchcock Iron Company, including the taxpayer
92 appellant and her mother, Louisa Andrews, entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, providing for the sale of their stock in the Andrews & Hitchcock Iron Company to the Youngstown Sheet & Tube Company, a true copy of which contract is hereto attached marked "Exhibit 1" and hereby made a part of this stipulation as if specifically written herein, together with a true copy of a certain written contract dated December 16, 1914, by and between the stockholders of the Mahoning Ore & Steel Company, which contract of December 16, 1914, was by reference made a part of said written contract of March 11, 1916.

4. On March 22nd, 1917, Louisa Andrews, the taxpayer's mother, died, leaving a last will and testament, which was duly admitted to probate and under which the taxpayer received by bequest a 550/4000ths interest in any payment that might subsequently become due under the said contract Exhibit 1.

5. The value of the said 550/4000ths interest so acquired by the taxpayer under her mother's will was fixed by the Commissioner of Internal Revenue for the purposes of Federal estate tax imposed upon the Estate of Louisa Andrews, at $277,164.50.

6. The value on March 1, 1913, of the 250 shares of stock of
93 the Andrews & Hitchcock Iron Company owned by the taxpayer and sold by her under said contract Exhibit 1, was in excess of the sum of $173,089.80, and exceeded the cost of said shares to her.

7. Since the sale of said 250 shares under the contract Exhibit 1 the taxpayer has received the following sums on account of the purchase price of said stock down to and including the year 1920:

1916 (taxpayer's share of $2,200,000.00 paid in cash under said contract, Exhibit 1)	$137,500.00
1917	9,900.00
1918	11,250.00
1919	8,995.50
1920	5,444.30

8. The total of the sums received by the taxpayer as a result of the sale of said 250 shares of stock owned by her under the contract Exhibit 1, down to and including the year 1920, was less than the value on March 1, 1913, of the 250 shares of stock sold.

9. Since the death of her mother, Louisa Andrews, on March 22, 1917, the taxpayer, down to and including the year 1920, has received the following sums under said contract Exhibit 1, on
94 account of the 550/4000ths interest in the future payments under said contract, acquired by her under her mother's will:

1919	$19,790.10
1920	$11,977.49

10. The total of the sums so received by the taxpayer since her mother's death, by virtue of the 550/4000ths interest in the future payments under said contract Exhibit 1, acquired by the taxpayer under her mother's will, was less than the value of the said 550/4000ths interest fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax upon the estate of Louisa Andrews, and less than the value of said interest at the date it was acquired by inheritance from her mother.

11. The taxpayer, between March 1, 1913, and December 31, 1920, kept no books, and her returns for Federal income tax purposes for the years 1916 and 1920, inclusive, were made upon the basis of cash receipts and disbursements.

12. A difference of opinion existed between engineers and experts employed by the Mahoning Ore & Steel Company on the one hand, and by the Commissioner of Internal Revenue on the other, both qualified by education and training in the iron mining indus-
95 try, as to the estimated annual production of said mine and its life as of March 11, 1916.

13. Engineers employed by the commissioner, qualified by education and training in the iron-mining industry to give such opinions, estimated that at the date of the contract of March 11, 1916 (Exhibit 1 attached hereto) that the ore reserves of the Mahoning Ore & Steel Company were 82,858,535 tons; that the average annual future production from said mine would be 1,841,300 tons; and that the life of the mine was 45 years from March 11, 1916.

14. The estimates mentioned above and adopted by the commissioner in this case, was based upon data obtained from the Mahoning Ore & Steel Company and the estimate furnished by that company's engineers, given in a proceeding to fix the depletion rate for the Mahoning Ore & Steel Company. It was based upon the content of recoverable ore in only approximately 620 acres out of the entire property leased by the company.

15. Since fixing the deficiency in this case, the Commissioner of Internal Revenue in a proceeding in which the depletion rate for the Mahoning Ore & Steel Company was changed, based upon data furnished by the company and the opinions of duly qualified engineers and experts employed by him, found that the life of said mine was forty years from March 1, 1913, and that the estimated
96 ore reserves of said mine on March 1, 1913, was 88,561,533 tons. The tonnage mined from said Mahoning mine from the 1st day of March, 1913, to the 11th day of March, 1916, was 5,039,655 tons.

16. The actual ore mined annually in tons for the Mahoning Ore & Steel Company between 1913 and 1926, inclusive, was as follows:

1913	1,515,428	1920	1,720,537
1914	1,212,287	1921	303,020
1915	2,311,940	1922	1,011,204
1916	2,215,788	1923	3,029,865
1917	2,525,144	1924	1,717,092
1918	2,019,481	1925	1,699,133
1919	1,217,167	1926	1,813,811

17. Assuming that the said Mahoning mine had ore reserves on March 11, 1916, of 82,858,535 tons, and further assuming that all said ore was mined, and 12% thereof, namely 9,942,664.2 tons was delivered to Youngstown Sheet & Tube Company, the total amount which would be received under the provisions of the contract of March 11, 1916, Exhibit 1, by all the vendors of said stock
97 and their successors in interest would be the sum of $5,965,814.52 at the rate of 60¢ per ton.

18. The present worth of the sum of $5,965,814.52 based upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6%, with provision for a sinking fund at 4%, was on March 11, 1916, $1,942,111.46.

(Signatures.)

WASHINGTON, D. C., *January 17, 1928.*

Exhibit 1 to agreed statement of facts

This agreement made and entered into at Youngstown, Ohio, this 11th day of March, A. D. 1916, by and between Louisa Andrews, Julia Andrews Bruce, Edith Andrews Logan, W. J. Hitchcock, Frank Hitchcock, H. W. Heedy, and the estate of U. A. Andrews, parties of the first part, hereinafter called the "stockholders," and the Youngstown Sheet & Tube Company (an Ohio corporation), party of the second part, hereinafter called "The Youngstown Company":

Witnesseth:

That whereas said stockholders are the owners of all the capital stock of the Andrews & Hitchcock Iron Company, (an Ohio
98 corporation), and the Youngstown Company is desirous of purchasing all of said stock for the benefit of itself and others, as hereinafter designated, upon the terms and conditions following:

Now, therefore, it is agreed by and between said parties as follows, to wit:

First. The stockholders, for themselves and their respective heirs, representatives, and assigns, agree with the Youngstown Company, for itself, its successors and assigns, that they will sell, assign, transfer, and set over to the Youngstown Company, and the others hereinafter designated, all of said capital stock of said the Andrews & Hitchcock Iron Company; and the Youngstown Company agrees that it will purchase said stock for itself and said others, hereinafter designated, and pay therefor to the Dollar Savings & Trust Company, of Youngstown, Ohio, for the benefit of said stockholders, the sum of one thousand dollars ($1,000.00) cash in hand upon the execution and delivery of this agreement, receipt whereof is hereby acknowledged; the further sum of two million one hundred ninety-nine thousand dollars ($2,199,000.00) on the 11th day of April, A. D. 1916, and the further sum in amount and manner to be determined as provided in paragraph 4 hereof.

Second. Said stockholders further agree that forthwith upon the execution and delivery of this contract they will deliver or
99 cause to be delivered to said the Dollar Savings & Trust Company all of said capital stock, properly assigned, and that they will cause said the Dollar Savings & Trust Company to deliver the same to said the Youngstown Company and others upon the payment of said sum of two million one hundred ninety-nine thousand dollars ($2,199,000.00) to said the Dollar Savings & Trust Company on said 11th day of April, as above provided, it being the intention of the parties that the title to said stock shall pass to and vest in the Youngstown Company, and said others, upon the making of said payment on April 11th, 1916, and that delivery of said stock and the making of said payment shall be simultaneous.

Third. It is understood that the capital stock of said the Andrews & Hitchcock Iron Company is four hundred thousand dollars ($400,000.00), divided into four thousand (4,000) shares of the par value of one hundred dollars ($100.00) each, and that the same is owned by said stockholders in the following several proportions.

Louisa Andrews	1,180 shares.
Julia Andrews Bruce	350 "
Edith Andrews Logan	250 "
W. J. Hitchcock	1,000 "
Frank Hitchcock	1,000 "
H. W. Heedy	100 "
Estate of U. A. Andrews	120 "

It is further agreed that said The Dollar Savings & Trust
100 Company shall deliver said stock to said the Youngstown Company and others as follows:

To the Youngstown Company	3,993 shares.
To James A. Campbell	One share.
To Richard Garlick	One "
To C. S. Robinson	One "
To William E. Manning	One "
To L. J. Campbell	One "
To C. D. Hine	One "
To E. L. Ford	One "

Fourth. It is understood that said the Andrews & Hitchcock Iron Company is the owner of twelve per cent or three hundred sixty (360) shares of the capital stock of the Mahoning Ore & Steel Company, a corporation of the State of Pennsylvania, having a capital stock of three hundred thousand dollars ($300,000.00) divided into three thousand (3,000) shares of the par value of one hundred ($100) each, which said Ore & Steel Company is the owner of certain valuable mines for the production of iron ore, and that the said the Andrews & Hitchcock Iron Company, by an agreement in writing in quintuplicate bearing date of December 16th, 1914, is entitled to take each year a full quota of each grade of ore to be produced by said Ore & Steel Company in proportion to the amount of stock owned by or represented for it, as provided for in said agreement, a copy of which is hereto attached and marked "Exhibit A" for the purpose of making the same a part thereof; and for the purpose of fixing the balance of the purchase price to be paid by the
101 Youngstown Company, it is therefore further agreed between said parties as follows, to wit:

That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of or to which the said the Andrews & Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the terms of said written agreement of December 16th, 1914, and shall give the notice provided for in said agreement, and will pay or cause to be paid to said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price each year on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2240) pounds of iron ore so entitled to be taken for such year, and actually delivered by said Ore and Steel Company, it being understood that if any part of the quota for one year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof.

Fifth. In order to secure the making of said deferred payment of said purchase price, as provided for in paragraph fourth, it is further agreed between the parties that said three hundred
102 and sixty (360) shares of Ore & Steel Company stock shall be properly assigned and deposited in the hands of said the Dollar Savings & Trust Company as collateral security therefor, and shall be held until all of the balance of said purchase price is fully determined and paid. If at any time the Youngstown Company fails to pay punctually any instalment of said purchase price as it falls due, and such default continues for the period of thirty

days after written notice and demand therefor made by the stockholders, or any of them, then any of said stockholders, in addition to any other lawful remedy, may elect to take and keep as and for his own, his proportionate share of said Ore and Steel Company stock to which his pro rata holdings of the stock of said the Andrews & Hitchcock Iron Company, as herein set forth, may entitle him, and shall have the further additional right to recover any and all costs, expenses, damages and attorney fees suffered or incurred by him in the premises.

It is further understood and agreed that the Youngstown Company will pay all costs, charges, and expenses, including attorney fees and compensation of the Dollar Savings & Trust Company connected with the making of this contract, and the full and complete performance of the trust herein provided for, it being the intention of the parties that said stockholders shall receive said sum of sixty cents per ton for ore and all other sums herein made payable to them, free and clear from any costs or expense whatsoever incident to the making or carrying out of this agreement.

103 Sixth. All payments made by the Youngstown Company to said the Dollar Savings & Trust Company shall be by it forthwith distributed and paid over to the stockholders in shares proportionate to their stockholdings in said the Andrews & Hitchcock Iron Company, as above set forth in paragraph third hereof.

Seventh. The rights and liabilities of the parties hereto shall extend to and be binding upon their respective heirs, or successors, administrators, executors, and assigns.

In witness whereof the parties have signed or caused their names to be signed to triplicate hereof the day and year first above written.

(Signatures.)

Exhibit A to agreement

AGREEMENT

(Executed in quintuplicate)

(Being Exhibit A referred to in the foregoing Exhibit 1)

Made this 16th day of December, 1914, by and between the present stockholders of the Mahoning Ore & Steel Company, said company having a capital stock of $300,000.00, divided into three thousand (3,000) shares each of $100.00 par, issued and held as follows:

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Name	Shares	Percentage
John A Topping, trustee (representing Republic Iron & Steel Co.)	180	6%
Frank Hitchcock, trustee (representing the Andrews & Hitchcock Iron Co.)	360	12%
Leonard C. Hann	65	
D. R. Hanna	63	
A. M. Robbins	33	
Simon Perkins	65	
C. C. Bolton	43	
Samuel W. Folsom	10	
L. C. Hanna and D. R. Hanna	80	
M. Andrews (represented by L. C. Hanna and C. C. Bolton, trustees)	1	12%
D. G. Kerr (representing Carnegie Steel Company)	1	
Carnegie Steel Company	600	20%
W. H. Donner	1,498	
Effingham B. Morris	1	
Herbert F. Black (representing Cambria Steel Company)	1	50%
	3,000	100%

Whereas by agreement bearing date 26th of April, 1897, between representatives of the National Tube Company, Andrews & Hitchcock Iron Company, Mahoning Valley Iron Company, Andrews Brothers Company, and Cambria Iron Company, it was agreed that the capital stock of the Mahoning Ore Company was held for the use of the said five manufacturers and consumers of ore as follows:

National Tube Works Company	20%
Andrews & Hitchcock Iron Co	12%
Mahoning Valley Iron Company	6%
Andrews Brothers Company	12%
Cambria Iron Company	50%

And it was provided that each of said manufacturers and consumers should be entitled to take its proportional part of the total output of ore mined per annum from the mines of said company at the cost of production and delivery as therein fixed and determined;

And whereas the Mahoning Ore & Steel Company was organized in pursuance of the provisions of said agreement and took over all leaseholds, property, and assets of the Mahoning Ore Company;

And whereas since the date of said agreement, there have been transfers of said capital stock of the Mahoning Ore & Steel Company and changes in the ownership thereof by and with the approval of all the parties in interest, and it is desirable to restate the respective interests as they now stand and more clearly provide, for disposal of the ore produced from the mine of the said Mahoning Ore & Steel Company;

Now, therefore, this agreement witnesseth that the entire capital stock of Mahoning Ore & Steel Company being now held as hereinbefore stated, each of the parties in interest hereby agrees that
106 the base agreement bearing date of April 26th, 1897, be, and hereby is, terminated, and that in lieu thereof the following terms and conditions shall hereafter govern the method whereby the iron ore produced from mines of said Company shall be disposed of.

First. The tonnage of each grade to be produced annually shall be fixed by the board of directors on or before April 1st, in each year, and notice of the fixing of said tonnage shall be mailed promptly to each stockholder.

Second. Each of the interests, as hereinbefore set forth, shall be entitled to take a full quota of each grade to be produced, in proportion to the amount of stock owned by or represented for them, and within 15 days after receipt of notice referred to in preceding paragraph, shall notify in writing the president of said Mahoning Ore & Steel Company whether or not it elects to take the full quota to which it is entitled. Undesired tonnage, if any, shall be offered pro-rata to the other stockholders, and such portion thereof not desired by them can be disposed of by the board of directors by reducing the originally fixed production to the extent of the unaccepted tonnage, or in any other manner the board of directors may agree upon.

Third. The price of ores shall be fixed each year by the board of directors and shall be at or about the cost of production, including all costs, transportation, delivery, handling, etc., to the lower lake ports. Delivery elsewhere with corresponding modification in
107 price, may be arranged in special instances, subject to the approval by the board of directors.

Fourth. Formal contracts shall be entered into annually with the company covering the tonnage and grade of ore which each interest or representative shall have elected to take, in accordance with the provisions of this agreement, and as estimated cost price will be named in said contract, based on preceding section, subject to adjustment to actual cost at end of ore season.

In witness whereof this agreement has been executed by the parties hereto, the day and year above written.

L. Cl. Hanna,
C. C. Bolton,
As Trustees.
D. C. Kerr,
(For Carnegie Steel Company).
The Andrews & Hitchcock Company,
By Frank Hitchcock, *Pt.*
W. H. Donner,
E. B. Morris,
Herbert F. Black,
Representing Cambria Steel Co.
Jno. A. Topping,
Trustee, Republic Iron & Steel Co.

108 There was then offered and received in evidence, as petitioner's Exhibit No. 1, a copy of the contract of sale between the stockholders of the Andrews & Hitchcock Iron Company, on the one part, and the Youngstown Sheet & Tube Company, on the second part, dated March 11, 1916, and which forms part of the agreed statement of facts as Exhibit 1 thereto and which is fully above set forth.

Thereupon, under the reservation to either party of the right to raise a question as to the materiality of any facts agreed upon, as set out in the agreed statement of facts, hereinabove set forth, attorneys for petitioner entered objections to the 13th, 14th, 15th, and 18th paragraphs of said agreed statement of facts, as follows:

Objections to stipulation

"Mr. Tompkins: On behalf of Edith Andrews Logan, under the rights of objection raised to the stipulation, I object to the 13th paragraph of the stipulation, upon the ground that it is incompetent, irrelevant, and immaterial, and has no bearing on this proceeding; that the test here is not as to the value of the Mahoning mine, but as to whether the obligation of the Youngstown Sheet & Tube Company under the contract of March 11, 1916, to make future payments, could be sold, whether a purchaser could be found so as to make it a closed transaction or not, and that, as matter of law, it would be error to value the contract and treat it as a closed transaction based upon the estimates made by the engineers merely as
109 to the life of the mine. The test here is whether the obligation of the Youngstown Sheet & Tube Company to pay 60¢ per ton for the ore under this contract could be sold and disposed of, whether there was any purchaser that could be found in the market in 1916 that would be ready and willing to pay cash or the equivalent of cash for that obligation. It is to preserve our legal rights that I make that objection.

* * * * * * *

"The MEMBER. As I understand it, there is no objection raised to the actual fact.

"Mr. TOMPKINS. Yes, sir; that is right.

"Mr. FORD. That is right.

"Mr. TOMPKINS. No; there is no question about that.

"The MEMBER. The record will simply show your objection to it. I do not see that it is necessary for me to rule upon it at the present time.

"Mr. TOMPKINS. If you rule later adversely to us, of course, you will save us an exception?

"The MEMBER. Yes; that is correct.

* * * * * * *

"Mr. MITCHELL. And the commissioner, in the event the objection is sustained, would also desire an exception.

"The MEMBER. That will be noted.

* * * * * * *

"Mr. TOMPKINS. May a similar objection be noted to this 14th paragraph? I suppose your honor will make a similar ruling.
110 "The MEMBER. Yes; that is correct.

"Mr. FORD (after reading paragraph 15 of the agreed statement of facts). A similar situation here arises, does it not?

"Mr. TOMPKINS. Yes.

"The MEMBER. A similar ruling.

* * * * * * *

"Mr. TOMPKINS. On behalf of the taxpayers, we object to paragraph 18 of the proposed stipulation, upon the ground that it is irrelevant and immaterial and has no bearing on the case, and that the contract of March 11, in evidence here, and the record as to actual tonnage show that this sum of $5,965,814.52 would not be received in equal annual installments over a period of 45 years.

"The MEMBER. I make the same ruling in this instance that I did in the other.

"Mr. TOMPKINS. The same ruling with reference to taking an exception?

"The MEMBER. Yes."

* * * * * * *

Said member later overruled said objections to the 13th, 14th, 15th, and 18th paragraphs of the agreed statement of facts, hereinabove fully set out, and duly noted exceptions on behalf of petitioner to said rulings.

Thereupon there was offered and received in evidence, as petitioner's Exhibit No. 2, a statement by the Commissioner of Internal Revenue attached to his notice of deficiency and identified by the symbols, IT:PA:1-VMW-104-60D, the material portions of which are as follows:

111 *Petitioner's Exhibit 2*

In re: Mrs. Edith Andrews Logan, 814 Stambaugh Building, Youngstown, Ohio

	Deficiency in tax	Overassessment
1915 (claim filed)		$18.60
1916 " "		1,441.15
1917 " "		491.73
1918 (waiver filed)	$994.05	
1919 " "	14,277.92	
1920 " "	6,776.66	
Total	22,048.63	1,951.48

Your income tax liability has been adjusted in accordance with the recommendation of the former Committee on Appeals and Review as follows:

* * * * * * *

1916

* * * * * * *

From a reconsideration and audit of the information and data on file, it is disclosed that no profit was realized in 1916 from the sale of the Andrews and Hitchcock Iron Company stock to the Youngstown

Sheet and Tube Company and, accordingly, the profit as computed by the revenue agent who verified your return has been excluded therefrom. A portion of the receipts from the ore shipments in subsequent years, however, is taxable, the basis of which is set forth in the statement showing the tax adjustment for your 1917, and subsequent years, returns.

* * * * * * *

112 1917

* * * * * * *

Add to net income reported on original return:

Ore payments of $9,900.00 received, less return of capital of $3,222.45 $6,677.55

You are advised that your taxable income from ore payments has been determined in accordance with the recommendation of the Committee on Appeals and Review. The following depletion schedule has been computed in accordance therewith:

Depletion schedule

Year	Receipts from ore	Tons paid for	Sustained	Depletion allowed	Claimed by omission
1917	$9,900.00	16,500	$3,222.45	$3,222.45	$9,900.00
1918	11,250.00	18,750	3,661.48	3,661.48	11,250.00
1919	28,785.60	47,976	9,478.14	9,478.14	28,785.60
1920	17,421.79	29,036	5,736.35	5,736.35	17,421.79

* * * * * * *

1918

* * * * * * *

Add to net income reported on original return:

Ore payments received from Youngstown Sheet and Tube Company, $11,250.00 less return of capital thereon of $3,661.48 $7,588.52

* * * * * * *

113 The ore receipts from the Youngstown Sheet and Tube Company less the return of capital thereon have been included as income as shown herein under the statement showing the income and tax adjustment for 1917.

* * * * * * *

1919

* * * * * * *

Add to net income reported on original return:

Ore receipts of $28,785.60 received from Youngstown Sheet and Tube Company, less return of capital thereon of $9,478.14 $19,307.46

* * * * * * *

The inclusion of the receipts of $28,785.60 in gross income representing your share of the ore payments by the Youngstown Sheet and Tube Company with a deduction therefrom of $9,478.14, representing a return of capital, is based on the schedule in the statement following your tax adjustment for 1917.

* * * * * * *

1920

* * * * * * *

Add to net income reported on original return:

Ore receipts from the Youngstown Sheet and Tube Company of $17,421.79 less return of capital thereon of $5,736.35---------- $11,685.44

* * * * * * *

114 The inclusion in gross income of the receipts from the Youngstown Sheet and Tube Company representing your share of the ore shipments with a deduction of $5,736.35, representing a return of capital, is based on the explanation of this transaction in the statement following the adjustment of your net income and tax liability for 1917.

* * * * * * *

Thereupon, there was offered and received in evidence as petitioner's Exhibit No. 3, the recommendation of the Committee on Appeals and Review of the Bureau of Internal Revenue dated February 4, 1924, as follows:

Petitioner's Exhibit 3.

RECOMMENDATION NO. —

Committee on Appeals and Review

In re: Appeal of Mrs. Julia Andrews Bruce, North Street, Greenwich, Connecticut

Years 1917, 1918, 1919, and 1920

FEBRUARY 4, 1924.

Mr. COMMISSIONER

(For deputy commissioner, head Income Tax Unit):

The committee has carefully considered the appeal of Julia Andrews Bruce, Greenwich, Connecticut, from the action of
115 the Income Tax Unit in proposing to assess additional taxes for the years 1917 to 1920, inclusive, predicated in part upon adjustments of net income hereinafter outlined.

Oral hearing was accorded the representative of appellant on January 16, 1924.

Appellant was the owner of 350 shares of a total of 4,000 shares of the capital stock of the Andrews and Hitchcock Iron Company.

The latter company owned 360 shares, or 12%, of the entire outstanding capital stock of the Mahoning Ore and Steel Company.

Under an agreement bearing date of December 16, 1914, between the Mahoning Ore and Steel Company and its stockholders, the latter were entitled to take, at or about the cost of production, including all costs, transportation, delivery, handling, etc., to lower lake ports, a full quota of each grade of ore produced by the company in proportion to the amount of stock owned by or represented for them.

On March 11, 1916, the stockholders of the Andrews and Hitchcock Iron Company contracted to sell to the Youngstown Sheet and Tube Company all of their holdings in the former company for $2,200,000 cash, of which amount there was paid upon execution and delivery of the agreement $1,000, and $2,199,000 on April 11, 1916, and a further consideration set out in the contract as follows:

116 "That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of ore to which the said the Andrews and Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the terms of said written agreement of December 16th, 1914, and shall give the notice provided for in said agreement, and will pay or cause to be paid to the said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price, each year on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2240) pounds of iron ore so entitled to be taken for such year and actually delivered by said ore and steel company, it being understood that if any part of the quota for any year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof."

The contract sets forth that it is "the intention of the parties that the title to said stock shall pass to and vest in the
117 Youngstown Company, and others, upon the making of said payment on April 11, 1916, and that delivery of said stock and the making of said payment shall be simultaneous." The contract further provides that the 360 shares of stock of the Mahoning Ore & Steel Company owned by the Andrews and Hitchcock Iron Company were to be properly assigned and deposited in the hands of the Dollar Savings and Trust Company as collateral security "until all of the balance of said purchase price is fully determined and paid," and that in the event of default in the payment of any installment continues for a period of 30 days after written notice and demand therefor by the vendors, or any of them, then any of

said vendors "in addition to any other lawful remedy, may elect to take and keep as and for his own his proportionate share of said ore and steel company stock to which his pro rata holdings of stock of said the Andrews & Hitchcock Iron Company may entitle him."

Upon the death of her mother, which occurred on March 22, 1917, appellant inherited a one-half interest in her mother's estate, including a 550/4000 interest in the contract of March 11, 1916. The value of this interest, for the purpose of the Federal estate tax, has been appraised at $277,164.50.

As deferred payments on the purchase price of her holdings in the Andrews and Hitchcock Iron Company, there was paid to appellant under the terms of the contract heretofore quoted, the following amounts:

118

1917	$13,860.00
1918	15,750.00
1919	32,383.80
1920	19,509.53

The appellant reported none of the above receipts as income on her tax returns, but rather treated them as a return of capital on the theory that she was entitled to recover the March 1, 1913, value of the stock sold, and the fair market value at the date of acquisition of the 550/4000 interest in the contract of March 11, 1916, acquired by inheritance, before reporting any receipts as income for tax purposes.

The Income Tax Unit has determined the total ore reserves in the mines of the Mahoning Ore and Steel Company on April 1, 1916, to have been 82,858,535 tons, and the life of the mines as 45 years from that date. On the basis of an ownership of 12% of the capital stock of the Mahoning Ore and Steel Company, the unit reasons that the total tonnage of ore to be delivered to the Andrews and Hitchcock Iron Company will amount to 9,943,024.2 tons, which, at the rate of $0.60 per ton, will yield payments amounting in the aggregate to $5,965,814.52 to the former stockholders. The present worth at April 1, 1916, of such payments, assuming that the same will be paid in equal annual installments, discounted at 6% with provision for a sinking fund at an equivalent rate compounded annually, the unit finds to be $2,049,018.65. As the appellant received
119 a 350/4000 interest in the contract of March 11, 1916, as a part of the purchase price of her stock, the unit further finds that the present worth at April 1, 1916, of her expected receipts was $179,289.13. Therefore, the unit finds that this amount of $179,289.13 plus $192,500 cash (350/4000×$2,200,000) or $371,789.13, was the consideration appellant received in 1916 for her stock, and as this selling price was more than the cost of such stock and less than the March 1, 1913, value thereof, the unit further finds in accordance with Treasury Decision 3206 that appellant realized no gain or loss from the sale of this stock in 1916.

Out of every $0.60 received by appellant as deferred payments during the years under consideration on her 350/4000 interest in the contract of March 11, 1916, the unit has held that 20.6 cents constitutes a return of capital, while 39.4 cents constitutes taxable income. The unit has accepted the value of $277,164.50 for the 550/4000 interest acquired by inheritance, as appraised for the purpose of the Federal State tax, and has held that out of every $0.60 received by appellant as deferred payments during the years under consideration on this 550/4000 interest, 20.86 cents constitutes a return of capital while 39.14 cents constitutes taxable income.

The appellant contends that this sale of stock should be treated as a sale of personal property partly for cash and partly for a
120 deferred consideration, and since the obligations represented by the deferred payments have no readily realizable market value the amounts received would be applied to reduce the "basis" of the property sold and be taxable only if, when, and to the extent that they ultimately exceed the "basis."

In support of this contention, reference is made to article 46 of Regulations 62 and S. M. 1353 and O. D. 482 (2 C. B. 77). Should this contention be rejected, then the appellant presents as an alternative that property was exchanged for a contract "calling for a series of annual payments or, in other words, for an annuity contract, in which event the case would fall under article 47 of Regulations 62, which provides that the amounts received under an annuity contract in excess of the premium or price paid therefor is income for the year of its receipt."

It should be noted here that the Income Tax Unit and the appellant are in accord with respect to the cost of appellant of her 350 shares of capital stock of the Andrews and Hitchcock Iron Company sold in 1916, and the March 1, 1913 value thereof.

The issues presented to the committee for determination may therefore be briefly summarized as follows:

(1) Is the Income Tax Unit correct in holding that the sale of this stock was a completed transaction in 1916, notwithstanding
121 the fact that the transaction involved deferred payments extending over an estimated period of 45 years; and

(2) If the unit's action with respect to the first issue is correct, how are the deferred payments, as and when received, to be treated for income tax purposes.

Under the provisions of article 26, par. 171, Regulations 33, revised, it was mandatory upon appellant to render her return for the year 1916 on the basis of cash receipts and disbursements. Therefore, unless it can be shown that the obligations of the purchaser were equivalent to cash, the transaction could not be regarded as having been comp'eted in 1916 and the appellant would be entitled to treat the same as a sale of personal property on the installment plan, as outlined in article 42, Regulations 45 (1920 edition). See O. D. 715 (3 C. B., 107). On the other hand, if it can be demonstrated that

the obligations of the purchaser were equivalent to cash, then the proper rule to be followed under such circumstances would appear to be that set forth in article 1564 (a), Regulations 45 (1920 edition), as amended by Treasury Decision 3206, and the case would fall within that provision of article 42, Regulations 45 (1920 edition) as amended, which states that "occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example a payment of more than 25%)
122 that the sale, though involving deferred payments, is not one on the installment plan."

It is with difficulty that a rule may be laid down as to when property may be said to have a fair market value. Each case must stand upon its own merits and be judged in the light of its own peculiar facts.

It implies the existence of a public of possible buyers at a fair price. The adjective "fair" emphasizes the idea of fairness inherent in this conception of market value and excludes any possibility of a construction of the words "market value" with reference to a market in which, or to circumstances of sale under which, for any reason, a fair price could not be obtained.

Having in mind the principle above enunciated and reviewing all of the facts peculiar to the instant case, the committee is clearly of the opinion that the 350/4000 interest in the contract of March 11, 1916, received by the appellant as a part consideration for her holdings in the Andrews and Hitchcock Iron Company had a determinable and assignable fair market value when received by her in 1916, and that such interest ought to be regarded as equivalent to cash. The contract of December 16, 1914, between the Mahoning Ore and Steel Company and its stockholders was iron-bound, and in the absence of any specific provision in the contract relating to the period of time covered by it, it is a reasonable presumption that it
123 applied to the total contents of the Steel Company's mines as and when produced. The contents of those mines can be and have been readily determined. Likewise was the contract of March 11, 1916, between the Youngstown Sheet and Tube Company and the former stockholders of the Andrews and Hitchcock Iron Company equally iron-bound, and assured to the latter deferred payments equivalent to $0.60 per ton on 12% of the total ore reserves of the Steel Company's mines. The deferred payments were secured by the 360 shares of the capital stock of the Steel Company owned by the Andrews and Hitchcock Iron Company which had been placed in the hands of a trustee for that purpose, and under the terms of the contract by virtue of which these shares were deposited with the trustee, the stockholders were assured that in the event of default in any of the deferred installments by the purchaser of the stock they would receive their pro-rata shares of the ore produced by the Steel Company, by exercising their option to take over the collateral security. There can be no doubt but what, under the circumstances,

the interest of each stockholder could be converted into cash without any material loss. The initial cash payment was in excess of 25% of the total selling price. The committee is, therefore, of the opinion that the sale by appellant in 1916 of 350 shares of the capital stock of the Andrews and Hitchcock Company for cash and deferred payments constituted a closed and completed transaction of that year.

124 The committee is of the opinion that the unit's computation of the present worth at April 1, 1916, of the appellant's 350/4000 interest in the contract of March 11, 1916, should be revised to the extent of providing a sinking fund at 4% rather than 6% as used by the unit. The result of this revision will show a present worth of $169,934.73 in lieu of $179,289.13 as computed by the unit.

The question of the manner of treating the deferred payments, as and when received, for income-tax purposes, presents no serious difficulties. It is obvious that if in computing gain or loss upon the transaction when completed in 1916, the appellant is given the benefit of a market value for her interest in the contract which is based upon the discounting of the gross deferred payments at the rate of 6%, then in reaching a conclusion as to how the deferred payments when received, shall be treated for income-tax purposes, the computation should merely be reversed and the deferred payments allocated to a return of capital in the same ratio as the total deferred payments bear to their discounted value and the balance of such deferred payments reported as income. Therefore, of every dollar received represented by the 350/4000 interest, $0.32554 represents a return of capital and $0.67446 constitutes taxable income. Of every dollar received represented by the 550/4000 interest acquired by inheritance, $0.33099 represents a return of capital and $0.66901 constitutes taxable income.

125 Accordingly, it is recommended that the action of the Income Tax Unit be modified as herein indicated, and that the appeal be denied.

(Signed),
Committee on Appeals and Review.

Approved:
(Signed) D. H. BLAIR,
Commissioner of Internal Revenue.

"Mr. FORD. I am not attempting to offer the closing letters in the other cases, because these are being offered for the purpose of showing the particular method of computation adopted in the department, and they are similar in so far as that is concerned.

* * * * * * *

"Mr. FORD. As I understand it, all of the stipulations are received?
"The MEMBER. Yes; that is correct."
Thereupon the following testimony was heard:

FRANK HITCHCOCK, having been duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

"My name is Frank Hitchcock, and I live in Youngstown, Ohio. I was formerly a stockholder and officer of the Andrews & Hitchcock Iron Company and immediately before March 11, 1916, was
126 president of that company. I negotiated, on behalf of the stockholders of the Andrews & Hitchcock Iron Company, the contract of March 11, 1916, entered into between those stockholders and the Youngstown Sheet & Tube Company. Mr. Campbell negotiated the contract on behalf of the Youngstown Sheet & Tube Company. He was then president of the Youngstown Sheet & Tube Company. His father was there, and Richard Garlick, but it was Mr. Campbell who did the talking. There were some other directors with Mr. Campbell at the time. The Andrews & Hitchcock Iron Company owned 12 per cent of the stock of the Mahoning Ore & Steel Company.

"Q. Referring to this contract of March 11, 1916, and the provision that some $2,200,000 be paid in cash, I will ask you whether that consideration of $2,200,000 was in payment indirectly for certain of the assets of the Andrews and Hitchcock Iron Company?

"Mr. MITCHELL. Just a moment. I object to that as calling for a conclusion and as not the best evidence. The contract itself shows what the payments were for and what they were made for.

* * * * * * *

"The MEMBER. The objection is overruled. * * * An exception will be noted.

* * * * * * *

"A. They were."

127 "Those assets comprised some small properties in Michigan. Some of them have turned out to be pretty good since then, but at that time they were pretty poor, I thought. They also included blast furnaces in Ohio, coal lands in Pennsylvania, and moneys in the bank. At that time these represented practically all the assets they had, outside of the value of the Mahoning Ore & Steel Company stock. There was no discussion at all to the effect that the present cash payment represented the interest of the Andrews & Hitchcock Iron Company in the Mahoning Ore & Steel Company stock.

"'Q. Why did you not bring up any discussion as to a present cash payment for that interest?

* * * * * * *

"'A. Being a minority stockholder, I did not think it was—I mean the Andrews and Hitchcock Iron Company being a minority stockholder in the Mahoning Ore and Steel Company, I did not think there was any chance of getting a cash value for the property, and did not bring it up, as to its worth. I mean cash value as to its worth.

"'Q. Mr. Hitchcock, at that time, namely, March 11, 1916, did you know of any market where you could have obtained, or did you know of any market where could be sold an interest of 12 per cent of the stock of the Mahoning Ore & Steel Company?

"'A. No; not at its value.

* * * * * * * *

"'Q. Mr. Hitchcock, in 1916, was there any price established by public sale or sales in the way of ordinary business of similar
128 contracts to this contract of March 11, 1916, in which the fair market value of the contract at that time, at the time it was made, could be determined?

"'Mr. MITCHELL. Objected to as calling for a conclusion of the witness.

"'A. No.

"'MEMBER. Objection overruled * * *,' an exception noted.

"'Q. Was there in 1916 any general market for contracts of this character and any established or current market price?—A. No.

"'Mr. MITCHELL. The same objection.

"'MEMBER. The same ruling.

"'Mr. MITCHELL. Exception.'"

Upon cross-examination, Frank Hitchcock testified as follows:

"I was president of the Andrews & Hitchcock Iron Company in 1916, before I sold out, and had been president since about January, 1900. My position in the iron industry made me familiar with the larger transactions that went on in that industry.

"I don't remember the sale of the Chemung mine and I do not know where the Chemung mine is. I do not know anything about the sale of the Kosmerl mine and I do not know where that mine is. I do not know of the Eva mine or the Ruth mine and I don't know any of those names just at present.

129 "In 1916, and for a few years before that, I had my office at Youngstown, Ohio. My duties required me to go up on the Mesaba Iron Range. I was up there two or three times a year, maybe oftener. It would depend altogether on what was going on then. We got monthly reports all the time. I made short trips in going over the property and other properties. The name, Tener mine, is familiar, but I don't remember at the present time just what the transaction was involving that mine. I don't know the sale prices of any mine at or around 1916. I know there were mines sold there, but I don't know about 1916, just exactly right there. When mines were sold I did not inquire into the circumstances nor familiarize myself with the transaction except in a general way. I am not aware of the fact that the United States Steel Corporation was buying mines during or around that time. They were interested in iron mines—in the Mahoning mine.

"'Q. Did I understand you to say that you did not think there was an chance of getting the cash value of the Mahoning property?—A. Yes; I said that. There was no chance of getting the cash value, on account of the minority holdings.

"'Q. When you sold out, did you feel that you had not obtained the cash value?—A. When we sold out? We did not get through this contract—we expected to get the cash value.

"'Q. Do you mean by your answer that you did not think you could get the cash value; you did not think you could get a payment in cash, the entire payment in cash?—A. We did not get the entire payment in cash.

130 "'Q. You do not mean to say that you were not getting a fair value for your property, did you?—A. No.

"'Q. You meant that you were getting it over a considerable term of years?—A. Yes.'

"I think that the United States Steel Corporation has bought some iron-ore properties which, collectively, are as big as the Mahoning mine. I would say that that company and other large companies of the same sort sometimes did buy large ore properties. The United States Steel Company bought most of the properties, and they were put together. They bought the Oliver Mining Company, which is still in business.

"'Q. Well, I understood you to say that you did not know of any market where 12 per cent of the Mahoning Ore & Steel Company stock could be sold at its value.

* * * * * * *

"'A. Not for its cash value.

"'Q. Not for cash value; and you mean by that not for the full purchase price in cash?—A. In cash; yes.

"'Q. But you are not prepared to say that there was no market existing in which a reasonable value could be obtained, partly in cash and partly over a period of years; you are not prepared to say there was not that sort of a market, are you?—A. I did not know of any.'"

131 JOHN B. PUTNAM, having been first duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

"My name is John B. Putnam, and I reside at Cleveland, Ohio. I am connected with Pickands, Mather & Company, in Cleveland. They are a steel company, a partnership. They operate iron and ore mines, and have coal, pig-iron, and vessel interests. They have approximately 35 iron-ore properties in their different companies. I am generally familiar to-day with iron-ore leases and contracts covering the taking of iron ore. I have looked over the contract marked "Petitioner's Exhibit No. 1," dated the 11th day of March, 1916, between certain stockholders of the Andrews and Hitchcock Iron Company and the Youngstown Sheet and Tube Company.

"Q. In 1916, was there any price established by public sales, or sales in the way of ordinary business of similar contracts, by which the fair market value of this contract of March 11, 1916, petitioner's Exhibit No. 1, at the time it was made, can be determined?

"Mr. MITCHELL. I object to all that as calling for a conclusion of the witness, whose qualification to answer has not yet been established.

"The MEMBER. The objection is overruled * * *; exception noted.

"A. I know of no such market for such contract.

132 "Q. Was there in 1916 any general market for contracts of that character or any established or current market price?

"Mr. MITCHELL. Same objection.

"The MEMBER. Overruled.

"Mr. MITCHELL. Exception.

"A. Not that I know of.

"Q. In your opinion, could the vendors, that is, the sellers, of this contract, petitioner's Exhibit No. 1, in 1916, on any sale of this contract, have readily realized in cash or its equivalent, its real value?

"Mr. MITCHELL. The same objection.

"The MEMBER. The objection is overruled—exception will be noted.

"A. I think not.

"Q. Why not. Give your reason.

"Mr. MITCHELL. The same objection.

"The MEMBER. The same ruling—an exception noted.

"A. The real value of that contract depends upon two things, in my judgment. It depends first upon the total amount of iron ore that will be taken out and taken by the Youngstown Sheet & Tube Company, and second upon the rate at which they will take that ore. All of the properties owned by the Mahoning Ore & Steel Company have not been explored, and the tonnage is not definitely ascertained, so that you would have a considerable amount of

133 uncertainty as to the total amount of tonnage which would be shipped under the contract, and which would measure the payment of 60 cents a ton.

"In addition to that, there is no minimum in the contract, and there is no control by the purchaser, or seller of that contract, over the amount that will be shipped each year.

"The amount of ore under this contract, and the stockholders' agreement to take the ore, which is referred to in there, is left to the control of the board of directors of the Mahoning Ore & Steel Company. They would determine each year how much ore would be taken from the property, and therefore how much these payments would be, and their determination each year would, of course, have to be dependent upon the conditions and needs for this particular kind of ore of the controlling stockholders of the company. Those conditions vary widely with the other sources of supply of ore which those stockholders have. The conditions of the steel business, how much the consumption of that ore was, and particularly of these ores here—the particular consumption of this particular ore by those stockholders would of course, depend upon the kind of pig iron and the kind of steel they wanted to make.

"I am not an export in metallurgy or what these ores would be good for, but I have had enough contact with the ore business to know that particular ores are used for particular purposes, and if the controlling stockholders have a large use for this particular kind of ore, they would probably fix the production higher
134 than if they had a relatively small use for this particular kind of ore. They might have other ore supplies, which would have to be taken into consideration.

"Of course, the iron and steel business is notoriously a business of feast and famine, as you call it; so you would have ups and downs.

"For example, the total production of the Lake Superior district in 1917, as I recall it, was about sixty-three million odd tons. In 1921 it dropped down below thirty million tons—twenty-three million tons, I think it was. You have those fluctuations in the total ore shipped from that district, and naturally you have to expect probably relatively larger fluctuations in the production of any one mine, which would be affected not only by the general conditions, but by the specific conditions with reference to that mine and that particular ore.

"I might also say, in addition to that, that I believe it is customary—indeed, it has been our experience—that iron-ore mines and leases and anything that is dependent for its value upon the total volume of iron ore, the rate of production, and so forth, are not customarily sold for cash. There have been sales of iron-ore mines, but I am not familiar with any, except in a general way, but the most universal practice in the Lake Superior district is to transfer title or permit the development of an iron-ore property through leases and contracts, which run over a period of years, and vary their payments with the total volume of ore taken out from the mines and the
135 annual rate of production. In my judgment, from the acquaintance I have had with it, that is the natural outgrowth of this kind of a situation, that the true value of those things can only be determined after the total ore reserves have been developed and shown and after you have been through the experience and determined what the actual production is going to be.

"'Now, I do not mean by that that it has no value, and I do not mean by that that you cannot arrive at some value for it; but so far as the cash sale value goes, customarily those contracts and interests in iron ore properties are not dealt in in that way.'"

Upon cross-examination, John B. Putnam further testified:

"'Q. You find that iron ore properties are ordinarily sold with the terms of payment closely related to the expected production; is that the idea?—A. No; they are customarily leased. You are referring now to a property owned in fee, where the owner wants it developed and the ore disposed of?

"'Q. Well, let us deal just with sales for the minute. When iron ore properties are sold, has it been your experience that payment ordinarily follows the expected rate of production and expected

life? For instance, if the mine sold is expected to have a life of 20 years, will you ordinarily find that payments are spread over 20 years?—A. I do not know of any sales of iron ore properties, except a sale that I heard about generally, which Jones & Laughlin
136 made to the Cleveland Cliffs Iron Company, of a small property on the Marquette Range. They sold that for cash a good many years ago, in connection with the sale of a lot of timber lands up there.

"'In addition to that, however, we have two properties, I think it is—two small properties in the Menomonee Range, buying a minority interest in the fee. Generally, in those cases, the thing comes up through the properties being inactive. They are subject to leases which have small minimums, and they get into the hands of some estates. They come to us with the lease, and they ask us to buy the fee.

"'Those are the only cases I know of where the fees of properties have been sold for cash.'

"I never heard of the United States Steel Company buying fees of ore properties for cash recently. If you include in a sale a situation of this kind—the Biwabik Mining Company, you might say, bought the fee of one of the forties of their mine, and they did it in this way: They took and bought it, and they gave back a contract which obligated them to pay so much a ton on every ton of ore they took out. Now, if you call that a sale, I have known of that one. I do not know as I have known of any others outside of that one.

"I never heard of the sale of the Eva or Ruth mine to the United States Steel Company, nor did I ever hear of the Eva or Ruth mine. I never heard of the Kosmerl mine. I have heard of the purchase of iron ore property by Henry Ford or his associates. I understand he bought the Imperial mine in fee.

137 "'Q. Well, is it not true that there is a possible market for iron ore properties in the Mesaba Range to such interests as the United States Steel and Henry Ford, or similar interests?

"'Mr. Tompkins. Just a moment. I object to that, on the ground that it is incompetent, irrelevant, and immaterial to the issue in this case. It is not as to whether there is any market for an iron ore mine in the Mesaba Range, but as to whether this contract of March 11, 1916, had any value, or whether there was any market for the deferred obligations under the contract.

"'The Member. The objection is overruled.

"'Mr. Tompkins. Exception.

"'A. In my judgment there is no market for a cash sale for any large or really valuable iron ore mine. Now, that sale of the Imperial mine to Henry Ford—there was an old mine, which three or four different operators had tried to make go, but had thrown it up. It was a poor quality of ore, poorly developed, and poorly situated, and, as you know, Mr. Ford has found it impossible himself, with his efficient methods, to make it go. I do not think that would be a

precedent for any other purchasers, and, as a matter of fact, Mr. Ford has now taken another property up there, which I understand he has christened the Blueberry. He has taken that by lease.
138 I think if the Imperial mine had been a really valuable mine, which the fee owners considered had a real value, they would never have gotten together on a cash price.'

"I have heard of the Leetonia mine. I never heard of that mine being sold. I heard indirectly one time that Jones & Laughlin had bought the stock of that company, as I recall it, or they had acquired all the stock or all the interest in the mine or lease, in some form, through acquiring either the stock of the mining company that held the lease or the stock of one of those furnace companies down there that had the lease. It was a complicated thing, and I do not remember the details of it, but I am quite sure it was not a sale of the mine. It is not my understanding that they went into the transaction without owning the mine, and came out of it owning the mine. I think they just owned the lease. I do not think there is any question but what the Mahoning mine could be sold; I do not think there is any question but what it could be sold for cash, or for cash payments over a period of years. What I have in mind is this, if I can make myself clear; I do not believe a seller, not under coercion of some kind, would ever part with his interest in the Mahoning mine for a cash consideration which would be as low as a buyer would pay for it, and the proof of the fact that that does not exist, is that normally in that district these interests are transferred under these, you might call them, installment contracts, although they are not installment, because the total amount is left open and indefinite.

"They are ordinarily sold with payments spread over the
139 term of years, or a substantial part of the payments, and with the total amount left indefinite and conditional upon the amount of ore extracted and the rate of payment is conditional upon the rate of extraction. I think, undoubtedly, there are some developed properties where the total amount of ore is pretty definitely known.

"I would say Pickands, Mather & Company operate about thirty-five mines. In my connection with that company, I have something indirectly to do with Federal tax matters, but that is not my specialty. In my connection with Federal tax matters I have found it necessary to fix the cash market value as of March 1, 1913, for those mines. We have to do so on every property and on every lease that we owned on March 1, 1913.

"I am 35 years of age. There is no question but what, if you have to fix a value, in my judgment, you can value any of these; you can value any contract; you can value any mine lease, but the result of our efforts to value our mining leases for depletion on March 1, 1913, has been demonstrated in a great many cases. We have come down here, and we have set up a certain value, and the department has discounted it, and finally gotten down to a figure that we could persuade them to take.

"Now, in many cases which I could name to you, it has turned out that all of the tonnage has not been valued; all of the value has not been given. We have actually shipped out of those mines a good deal more in certain cases, already; and in more numerous cases we have developed more ore, and now have in sight
140 tonnages which, when taken with the production we have shipped since 1913, will give a considerably larger tonnage than was valued at March 1, 1913. That does not mean, of course, that the properties did not have a value on March 1, 1913. It means that it had a considerably larger value, a considerably greater value, than was granted by the department, but we just had to take these lower values because of this kind of a market situation that you have that results in these leases.

"I am familiar with the Mahoning property in a general way. I have been there and I know what the holdings are, just in a general way. I am not an engineer. I just know in a general way that out of about one thousand and odd acres of land, a certain part of it is generally explored, and a certain part of it is not."

J. C. AGNEW, having been first duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

"My full name is J. C. Agnew, and I live in East Aurora, New York. I am a mining engineer. I have been connected with the Mahoning Ore & Steel Company and first entered their employ in 1904 as an engineer. I was connected with that company until about April 1, 1923. About 1912 I was made general superintendent of the Mahoning Ore & Steel Company. On approximately
141 January 1, 1919, I was made assistant to the president of the Midvale Steel & Ordnance Company, and also director of the Mahoning Ore & Steel Company.

"The Midvale Steel & Ordnance Company acquired a half interest in the Mahoning Ore & Steel Company, through its acquisition of the Cambria Steel Company. I think that was about 1915 or 1916.

"The Midvale Steel & Ordnance Company was a combination of various companies, of which one was the Cambria Steel Company. The mine of the Mahoning Ore & Steel Company is located near Hibbing, in St. Louis County, Minnesota, on the Mesaba Range. I was resident at that mine until the 1st of January, 1919, or the later part of 1918.

"In 1916, approximately one thousand acres of mineral property was owned by the Mahoning Ore & Steel Company. At that date about six forties (six 40-acre sections), approximately 240 acres, were under operation or had ore taken from them. As to the remaining properties, some had been explored in whole or in part. The entire property never had been explored. I would say that, in addition to that portion that was in operation, about one-third had been either pretty well explored, fairly explored, or you could see some evidence of tonnage around the edges but not sufficient to determine the tonnage. In addition to those six forties that I have spoken of,

I would say that there was probably another 60 or 80 acres that was quite thoroughly explored. Of that thousand between 400 and 500 acres had either been totally or practically unexplored.

142 "The Mahoning Ore & Steel Company did not own the fee of that property; they had a 99-year lease. From my familiarity with that property and my employment with the company I am able to state concerning the period up to 1909 or 1910 whether the company had any definite policy as to the amount of annual production. Up until that time the policy was one of conservation. At a production of 1,000,000 to 1,500,000 tons, and all the physical conditions that existed at the Mahoning mine, a very reasonable cost of production could be obtained. Also at about 1,000,000 or 1,500,000 tons their royalty at 1,500,000 had reached its minimum of 12½ cents.

"I am familiar with the State tax situation prior and subsequent to 1909 or 1910. About 1906 or 1907 taxes were very reasonable on the Mesaba, and, commencing about 1907, they commenced to rise very rapidly. Take this Mahoning Ore & Steel Company. The taxes had risen from about $40,000 in 1906 to about $244,000 in 1912 and to about $482,000 in 1916.

"This policy of conservation, existing prior to about 1909 or 1910, underwent a change. That change took place about 1911, as I remember, occasioned by two things: First, the fact that the presidency of the Cambria Steel Company passed into the hands of Mr. Donner. The Cambria Steel Company was a 50 per cent owner in the Mahoning ore industry, and it was determined that more of this ore should be used at the Cambria plant at Johnstown, Pennsylvania, so that a plan was laid out for increased stripping and general

143 equipment of the property, so that this increased requirement could be met. This increased stripping took place about 1911, 1912, and 1913.

"The plan was to put the mine in position to produce 3,000,000 tons a year. It was put in that position. I might say that about that time a contract was made between the Cambria Steel Company and the Pennsylvania Steel Company, by which the Pennsylvania Steel Company had the right to take from the Cambria Steel Company ore from this mine to the extent of a portion of their requirements at Steelton, with a maximum requirement on the part of the Pennsylvania Steel Company, as I recollect it, of a half million tons. Mr. Donner also was president of the Pennsylvania Steel Company.

"From my familiarity with the Mahoning Ore & Steel Company property and the business and physical conditions surrounding it, at about March 11, 1916, I could not estimate with reasonable certainty the expected future production of that mine by years, annually.

"That mine was the property of the various shareholdings, interests that, I believe, have been mentioned here, all of whom were consumers of the ore. The production of the property was determined from year to year based on their needs, and their needs fluctuated,

for any number of reasons—business conditions, changes in their own practices, rearrangements of their own ore affairs, so it was very difficult to predicate any production. Our position as operators of the mine was at all times to be ready to meet their requirements.

"In my opinion, general business conditions of the Steel
144 Company had an effect on the annual production of the Mahoning mine. In times of depression it would be reflected in the production from the mine. The production of the mine would fall. In times when business was good the production would be up. Of course, during the war those things were restricted more or less by distribution.

"The effect of the European war, as I could foresee it, at about March 11, 1916, of course, caused an upward tendency on the annual production of the Mahoning mine, but I think it was in 1917 or 1918 that the railroad administration stepped in, and we were limited. Our people wanted something over 3,000,000 tons, but our tonnage was reduced, in my opinion, to about 2,500,000 tons. The production in 1921 is typical of an extreme fluctuation—303,000 tons.

"In March of 1916 you could not tell with reasonable accuracy the total content of ore in all of Mahoning Company's ore properties. That had something to do with the extent of the exploration. There were between four or five hundred acres of property on which the exploration was either not made or else the exploration was not sufficiently clear to give any estimate.

"'Q. Well, as to the part of the property explored, do you think that could be determined with reasonable accuracy as to the amount of tonnage?—A. That is about three hundred acres out of the entire thousand.

* * * * * * *

"'Q. Mr. Agnew, you have seen this contract of March 11,
145 1916, petitioner's Exhibit No. 1 [handing same to the witness]?—A. Yes.

"'Q. In 1916 was there any price established by public sales or sales in the way of ordinary business, of similar contracts, by which the fair market value of that contract at the time it was made, could be determined?—A. No.

"'Mr. MITCHELL. I object to that as calling for a conclusion.

* * * * * * *

"The MEMBER. The objection is overruled * * *; an exception is noted.

* * * * * * *

"'Q. Was there, in 1916, any general market for contracts of that character, and any published or current market price for the same?—A. Not to my knowledge.

"'Mr. MITCHELL. The same objection.

"'The MEMBER. The same ruling * * *; an exception will be noted.

* * * * * * *

"'Q. In your opinion, could the vendors or the sellers under that contract or any sale of the contract have realized in 1916, in cash or its equivalent, its real value?

"'Mr. MITCHELL. The same objection.

"'The MEMBER. The same ruling.

"'A. No; I do not think so.

"'Mr. MITCHELL. Exception.'"

146 Upon cross-examination, J. C. Agnew further testified:

Attorney for respondent handed the witness a map (respondent's Exhibit A), with reference to which the witness testified as follows:

"This map shows the location of the Mahoning property. The main property to which I referred is there in those eight forties [indicating on map]. Now there is a 60-acre tract right here [indicating on map]. Then, there are two in here [indicating on map]. Now, there are three forties in section 19, right next to the Itasca County line. There are two forties near the St. Paul line, again in Itasca County. Then there is one other isolated 40-acre piece."

Said map was then offered and received in evidence and marked "Respondent's Exhibit A," a true and correct copy of which is attached hereto.

The witness then, upon request of attorney for respondent, marked on said map (Exhibit A) the lands of the Mahoning Ore & Steel Company in 1916, and stated at the same time that there are three forties in Itasco County that are not marked on it.

The attorney for respondent also handed to witness a second map (respondent's Exhibit B), prepared from descriptions of the Minnesota authorities, with respect to which, witness testified as follows:

"This map (Exhibit B) shows the location of a portion of the principal ore lands of our company in 1916. They are the
147 principal ones now. The portion set out on this map includes the part which was being actively operated in 1916."

The map was then offered and received in evidence as respondent's Exhibit B, a true and correct copy of which is attached hereto.

The witness continued to testify as follows:

"I am not familiar with the Federal income and profits tax matters in which the company was involved while I was general superintendent. I am familiar with the tax situation between the company and the State of Minnesota. The State of Minnesota found an ore content only in the land set out on respondent's Exhibit B. It did not value on an ore content basis any of the company's lands other than the land set out on Exhibit B.

"Both the Minnesota Tax Commission and the Federal Government arrived at their knowledge of this property from explorations made by the company itself. Neither the Minnesota Tax Commission nor the Federal Government ever did any drilling or exploration on this property. The tax commission got data—I can not speak so well for the Federal Government—from all of the com-

panies which in any way had worked around this property, so that they had more information than we, as a company, had, and with the information thus obtained, the Minnesota Tax Commission put a tonnage on these properties. They put a valuation on the properties. That does not mean, as I interpret it, that there was no tonnage there. It simply means that, whatever you did, you would simply be putting a valuation on the ore; so why not just value it as mineral land, which the Minnesota Tax Commission had a
148 perfect right to do. They could value your property either on the basis of your tonnage, or they could simply value it as land. The Minnesota Commission did not attempt to find any tonnage on the land not shown on Exhibit B. That also applies to the United States, i. e., the Federal Government only found tonnage on the lands shown on Exhibit B.

"When I said a little while ago that in 1916 one could not tell with reasonable accuracy the tonnage content of ore, my answer applied to the entire holdings. I do not think that in 1916, the total content of ore in the lands disclosed by Exhibit B could be estimated with reasonable accuracy. Of the lands shown by Exhibit B, I would pick lots 2, 3, and 4 in section 1; lots 1, 2, and 3 in section 2; the northwest quarter of the southeast quarter of section 2; the north half of the southwest quarter of the southeast quarter of section 2, as being the only lands, in my opinion, in which the ore content could be determined with reasonable accuracy. Those lands include all of the lands in sections 1 and 2, except the northeast quarter of the northeast quarter of section 1 and the northwest quarter of the northwest quarter of section 2. I want to qualify that statement, however. There are in the area which I outlined as fully explored certain areas which are not fully explored, but they are within the operating area. My statements apply only to the portion of the section marked in black on Exhibit B.

"Now, as to the land shown by Exhibit B, where I said the ore content could not be ascertained with reasonable accuracy, that
149 situation existed because there was not sufficient exploration.

There were really three sorts of exploration that had been done there. The first was the old work which was originally done back in 1893 or 1894 or 1895, consisting of test pits, and that touched the ore and was the basis on which this property was selected originally. Then, as time went on, the properties were put in operation adjoining this area in sections 3 and 10, so that you could go there and see, standing out on the line. There were, I think, something like 15 or 20 drill holes put down in this property subsequent to that.

"'Q. You mean by "this property," the company's holdings in sections 3 and 10?—A. 3 and 10.

"'Q. 15 to 20 drillings?—A. That is my recollection.'

"The adjoining land was being mined or had been mined in 1916 so that you could see something of the ore that lay on these properties. You could see it along the boundary line.

"'Q. Well, take the two 40-acre parcels in sections 1 and 2, which you say were not susceptible of an accurate determination. Is it not true that the company's own workings adjoined both of those parcels?—A. Yes, sir; it did.'

"We had something like 15 or 20 drill holes on each of those two 40-acre parcels. Our company had an open pit in the six 40-acre parcels lying along the north line of sections 1 and 2.

150 "The operation of our company's mine as it existed in 1916 was what is commonly known as stripping. This ore was covered by a glacial drift, and this drift was taken off and removed by steam shovels, and taken out and dumped. Then the iron ore was loaded by steam shovel right into the railroad car for transportation. Everything was standard gauge. I do not know whether that is enough of a picture of it. We had an open pit something like a mile and a half long, and in some places the width was approximately 1,300 feet. The Mahoning Ore & Steel Company's property happened to be a portion of one of the biggest ore deposits of the Mesaba Range.

"Adjoining those eight forties, the United States Steel Company was conducting an operation, known as the Hull Rust mine. To the east of it there is the Sellers mine, operated by the United States Steel Corporation, and if you want to trace out that pit you will be going beyond the realms of my knowledge. I had nothing to do with their operations. I am trying to talk to you as an operator on the Mahoning Ore & Steel Company's property, and when we reached that point we were done. That is the limit. If you include the property operated by the United States Steel Company, you can conceive of an opening standing where we are now, and looking off there for a distance of pretty nearly two miles, with very irregular sides, and probably a portion of it is three-quarters of a mile wide. Throughout that area there are stripping operations going on, taking out the overburden, and then there are shovels and locomotives and rail-

151 roads and all of the activities that go to making up the mining of ore, drilling, and blasting. It is really quite a sight.

"Of the holdings of my company, as shown on Exhibit B, I made an estimate of the eight forties that I described, and I have given my best opinion as to what was in the balance of it. When I speak of an estimate of a property like this, on which I was operating—let us understand each other clearly—I was making an estimate on which I had to perform. The ore not only had to be there, but it had to be there in quantity and in the grade that I said it would be there, and I had to produce it every year, as I said I would. That is what I mean by an estimate. Now, you can take this other property and you can do as the tax commission did; you can take all the area around it and say this forty next to that produced so many tons of ore, and therefore it is reasonable to expect that this one would, and you can get a figure on it. You do not suppose that I tramped over all of that property for years without making my own guess as to how much tonnage it would produce. Of course I

did, and of course I looked at every one of those forties. I knew them like I know a book. I made a guess of what was there, but it was a guess. In reporting to the stockholders, I would definitely advise them that as to eight quarters, I had given a fairly accurate estimate, and as to the others, I would advise them that it was merely a guess, because it might be my opinion, and Mr. Bill Jones, another engineer, might come up and say, 'Agnew, I don't agree with you; it might be something else,' and I could not refute it.

152 "Before I would allow my opinions to be published, I would distinguish between my estimate and my guess. If I allowed my opinions to be published to the commissioner, I would distinguish in the same way."

Upon request of attorney for respondent, a document, marked "Respondent's Exhibit C for identification," was then handed to the witness, who testified with reference thereto as follows:

"The paper marked for identification as 'Respondent's Exhibit C' is my own affidavit. I signed that and swore to it. That affidavit sets out my opinion of the ore content on this land that we have been talking about."

Said respondent's Exhibit C for identification was then offered and received in evidence as respondent's Exhibit C, which is as follows:

Respondent's Exhibit C

STATE OF PENNSYLVANIA,
County of Philadelphia, ss:

J. C. AGNEW, being duly sworn, deposes and says:

That he resides in Ardmore, Montgomery County, Pennsylvania. That he is a mining engineer, and is familiar with the development, exploration, and operation of the properties of Mahoning Ore & Steel Company, located in St. Louis and Itasca Counties, Minnesota, operated by said company under lease from Grant Iron Mining Company.

That deponent made estimates from time to time of the amount of stripping required to be done upon said properties, obtaining
153 the information upon which such estimates were based, from explorations and drillings made thereon. That from the estimates so made, it appears that on March 1, 1913, on tract 1 (lots 1, 2, 3, and 4 of section 1, and lots 1, 2, 3, and 4 of section 2, of township 57, range 21), the stripping to be done aggregated 11,580,000 cubic yards. From the experience of deponent and the Mahoning Company in connection with the stripping of said property, deponent avers that an average cost of 22.4¢ per cubic yard is a fair estimate of the cost of stripping said property, making a total cost of the stripping remaining to be done thereon of $2,591,920. That the cost of stripping done on said property prior to March 1, 1913, was $1,893,790.81, making the total cost of stripping said property $4,485,710.81. The tonnage estimated in said property as

of March 1, 1913, is 64,756,588 tons, and there was mined out prior to 1913, 16,581,337 tons, making a total of 81,337,925 tons. Averaging the total cost of stripping over said tonnage gives an average cost of stripping of 5.5¢ per ton.

As to tract 2 (NW. quarter of SE. quarter and N. half of SW. quarter of SE. quarter of section 2, township 57, range 21), the stripping to be done on March 1, 1913, aggregated 1,500,000 cubic yards. Assuming a cost of 22.4¢ per cubic yard, makes a total stripping cost of $336,000 for tract 2, or, distributed over all of the tonnage in the property, 9,450,891 tons, gives an average cost of stripping of 3.55¢ per ton.

As to tract 3 (being SE. quarter of SE. quarter of section
154 3 and NE. quarter of NE. quarter of section 10, township 57, range 21), the stripping to be done on March 1, 1913, aggregated 13,500,000 cubic yards (each cubic yard of taconite in such computation being treated as three cubic yards of stripping). At a cost of 22.4¢ per cubic yard, the total cost of stripping will be $3,024,000, or, distributed over the tonnage in the property, 7,533,969 tons, gives an average cost of stripping of 40.1¢ per ton.

As to tract 4 (being N. half of NW. quarter and SE. quarter of the NW. quarter and NW. quarter of SW. quarter), the stripping to be done aggregated on March 1, 1913, 15,200,000 cubic yards (each cubic yard of taconite in such computation being treated as three cubic yards of stripping). At a cost of 22.4¢ per cubic yard, the total stripping cost will be $3,404,800, or at the rate of 31.8¢ per ton on the 10,709,600 tons alloted to the property.

From the information at hand as of March 1, 1913, we would estimate that tract 1 could produce 2,300,000 tons for a period of 25 years, and that the tonnage remaining in tract 1 at the end of this 25-year period would be mined out in 5 or 6 years.

This prediction is based on operating the property in such a way as to permit of producing 2,300,000 tons over the longest period possible, which would be accomplished by cleaning up or "scramming" the ore lying on the rock as mining operations progress and not postponing this "scramming" until the last possible
155 moment. As a matter of fact, this policy has been followed in the past, although to date the number of places where the ore has been bottomed are very few, comparatively speaking. In view of the extent of this property, there is no reason why such a policy can not be followed out, and in our judgment it should be.

(Sgd.) J. G. AGNEW.

Sworn to before me this 20th day of November, 1920.

[SEAL.] (Sgd.) GRACE M. WOODRUFF,
Notary Public.

The witness (Mr. Agnew) then continued his testimony as follows:

"The map (respondent's Exhibit B) sets out tracts 1, 2, 3, and 4, referred to in my affidavit."

The witness then marked the map (respondent's Exhibit B), to indicate the respective tracts and continued as follows:

"From an examination of my affidavit I find that I made estimates of all four tracts shown on Exhibit B, and did not distinguish my estimate in any way. I did not distinguish my opinion as to the four tracts as between estimates and guesses. I made no distinguishing marks at all in this affidavit. From an examination of this affidavit, Exhibit C, I find that I have also given opinions of probable life of the portion of the company's holdings that were being actively operated. This is set forth in the third paragraph on page 2 of the affidavit as follows:

156 "'From the information at hand as of March 1, 1913, we would estimate that tract 1 could produce 2,300,000 tons for a period of 25 years and that the tonnage remaining in tract 1 at the end of this 25-year period would be mined out in five to six years.'

"There was more difficulty in estimating a probable life for tract 2, tract 3, and tract 4 than there was for tract 1. This is an estimate of what it would be reasonable to assume that this tract 1 produced over the period from March 1, 1913. Now, that does not mean that if the stockholders wanted three or four million tons it could have produced it. It is merely an estimate of what they could produce. This estimate was made for purposes of depletion of that property, and was stated as from March 1 to May 8, 1921. I was asked to make this estimate by the president of the company, in order that the company might prepare its case for depletion. That is what this estimate is. It is one estimate of the probable life of tract 1."

Attorney for respondent then handed the witness another map (respondent's Exhibit D), with reference to which the witness testified as follows:

"This is a map of tracts 1, 2, 3, and 4 that we have been talking about and surrounding country. It sets out generally the drill holes and the mining pits in that country and as to that area. It is dated January 1, 1913, and was prepared by the engineers of the company."

157 Said map was then offered and received in evidence and marked "Respondent's Exhibit D," a true and correct copy of which is attached hereto. Witness then continued to testify:

"I do not know what the date means, whether that was the date of preparation or not. There have been made here additions to the date and legend. Whether that is the date on which the map was made, or whether it is the date on which the map was to be used, I am not sure. The date, January 1, 1913, is on it, and it would be my best information that this map was prepared for use in valuing the properties as of January 1, 1913, and would show the condition as of January 1, 1913.

"As to tract No. 3 I find that almost all of the west side adjoins an existing pit, and that half of the east side of that tract adjoins an open pit. As to tract No. 4 I find that a quarter of a mile on the east side and a quarter of a mile on the north side adjoin an open pit.

"As to tract No. 2 I find that considerable portions of the boundary of that tract adjoin an open pit. Tract No. 2 was not thoroughly explored. There is not much question about the tonnage, in that, and this is simply corroborative evidence. As to tract 3 and tract 4 it was on such data as mentioned that the Minnesota Tax Commission prepared their tonnage estimate on each portion. My affidavit is dated in 1921. Probably you did not have the record here.

"We drilled some holes on these properties to see whether the tax commission's estimate was too high. Such holes as we did drill
158 indicated that the tax commission's estimate was a conservative estimate, and we stopped there. My affidavit is based not only on the data indicated by the map, but on later explorations, and those later explorations indicate that the estimate in my affidavit was correct.

"In estimating the future production of the Mahoning mine as of 1916, I think the first factor is, as I have stated, the physical condition of the property. The property was able to produce 3,000,000 tons or more, so far as the property was concerned. Now, the other phase of the situation is the one that I went into a little earlier in my testimony, of the various requirements and demands of these stockholders from time to time, and that you can only judge from their plans and from what they proposed to do. The general demand for iron ore in the United States would be an important factor, but you are dealing here with one of the cheapest ores that are produced on the range, and you always have the other phase of the situation, that your steel company is striving for cost, and they might use that ore, because there is a saving even when times are hard. It is not so important when they are making money, so you have all those things to balance there. The general demand in this country for iron ore would be an important factor. Another important factor would be the condition of the industry in this country, i. e., whether times were prosperous or otherwise. It has been my experience that the demand for iron ore bears a fairly close relation to the general prosperity of the country.

"I am familiar with a publication called 'The Iron Ores of
159 Lake Superior,' put out by Crowell & Murray. They are always kind enough to send me one. I would regard the figures set out in that book for yearly shipments from the Mahoning mine as reasonably accurate."

Thereupon counsel for respondent read into the record the statement of yearly shipments of ore, as shown by the book The Iron Ores of Lake Superior, for a period from 1900 up to and including 1912:

1900	911,021 tons.	1907	1,564,382 tons.
1901	765,872 "	1908	611,592 "
1902	1,038,645 "	1909	1,561,893 "
1903	1,009,446 "	1910	1,515,728 "
1904	706,325 "	1911	1,011,945 "
1905	1,001,661 "	1912	1,518,643 "
1906	1,274,232 "		

"These yearly shipments of ore would, for all practical purposes, be equivalent to the annual production, and the record just read corresponds substantially with my own record.

"I do not think that the record just read coupled with the record of production set out in the stipulation indicates that the production of this mine is on a pretty even basis. If you will continue on there, you will see that there has been an increase.

160 "'Q. Yes. And don't you find that increase is a steady and somewhat slow increase?—A. Well, you have the figures there. I would say that there were some pretty substantial jumps there. I have not the figures in front of me.'

"We have in these records of production that there was a change in policy in this mine along about 1912, 1913 or 1914. The 1912 production is 1,518,000 tons. In 1913, it was 1,500,000. In 1914, the beginning of depression, it was 1,212,000. Then we jump up to 2,300,000, an increase of 1,000,000 tons. Leaving out the depression here, there is an increase of 800,000. Then we went along 2,300,000, 2,200,000, 2,500,000. Then you get your postwar period, 1,200,000, 1,700,000, and getting into 1921 we only had 303,000. From the standpoint of the production, 1921 was the worst year in the history of this company, after we got into active production.

"I would not say that the period from 1913 up to 1926, inclusive, could be considered as a representative period, taking the period as a whole. I would say that for two reasons. You have your war years there of 1917 and 1918, and then you have your postwar years there, and that is evidence again, you see, by 1923, where you get to 3,000,000 tons. It is pretty hard, I think, to make a statement that any past ten years is necessarily indicative of what the next ten would be on this property, because you have all of those changing factors there. For instance, this property in 1923, changed hands again.

The interest which the Midvale Steel & Ordnance Company
161 acquired from the Cambria Steel Company passed in 1923 into the hands of the Bethlehem Steel Company.

"I don't know the maximum capacity of that mine in 1916. Up to 1914 or 1915 I could have shipped six or seven million tons per year, if anybody could have hauled it away from there. We had capacity for 3,000,000 tons during a year, but it was not contemplated that the company would produce 3,000,000 tons a year. The company's plan or program which resulted in the stripping of 1912 and 1913 was to have the property always ready to supply to its stockholders at least 3,000,000 tons per year. Now, in order to do that, there were certain periods of war involved in the proposition, that I do not know we need to go into here, but you had to have sufficient area, and sufficient equipment, so that in addition to producing this 3,000,000 tons of ore, you had to produce 3,000,000 tons of the character of ore that your stockholders desired, roughly speaking, Bessemer and non-Bessemer. Three million tons a year is all that we planned to produce.

"We did not actually produce 3,000,000 tons a year, but that was the plan. Otherwise, there would not be any need for that investment in stripping. I think we could have produced 3,000,000 tons in 1913, but I am not sure whether we could have made the grade or not, because our stripping program was not completed at that time. I do not think it was actually completed until 1914, as I remember it.

"The actual production in 1914 was 1,212,000 tons. We
162 have that discrepancy between actual production and this plan, because, if you will put your memory back to 1914, it was a pretty poor year in the iron and steel business and in business generally.

"The next year, there was considerable demand for iron ore. You see we had reached 2,300,000, but we were still 700,000 short of 3,000,000, because the stockholders did not want it. I can not explain why they never did want it until 1923, because I did not know their business. I mean, here were a group of men, six of them, all administering, or most of them, as presidents of various steel companies, with all of the ramifications that they involve. Now, they gathered together and they said, 'We want this many tons out of there.' I have seen them change their minds two or three times in six months, but it would be pure supposition on my part to try to say what factors determined them in setting that tonnage. Of course, you have always to remember that in this situation here you had a lot of stockholders who wanted to agree—I mean, one fellow, if he found that the majority wanted a certain thing, if he possibly could, he would agree with them, and then he would go out and arrange his own affairs accordingly.

"As to making any estimate of the probable life of this mine as a whole, you can divide tonnage by any production that you like, and of course, you get all kinds of lives to it, and then you can take this affidavit, which is as near as I ever came to it. When you commence
to talk about these forties out to the west of there, in Section
163 18 over in Itasca County, there is no basis whatever to go on.

This affidavit is the first real attempt that I ever made at determining the life. We did make an estimate of the glacial drift on top of the ore in tracts 3 and 4. I did exactly as you indicated. We went and observed around the periphery of these properties, and arrived at what the overburden was. We took drill holes such as we had, and found out what there was in those, and on that basis we made an estimate. We did make an estimate of the ore body itself in that affidavit. I think you will find that estimate, if my recollection is correct, is the same as the Minnesota Tax Commission used.

"In my reports to stockholders I did not find it necessary to estimate the future life of the property. You see when you are dealing with such a large ore body as that, if you predicate your operating conditions for ten or twelve years ahead, that is as far as

you need to go. There is no use of your going further, because you get into the realm of uncertainty, where you accomplish nothing. Going back to that blue print there, there are some of these drill holes that do not go to the bottom of the ore body at all. I remember one that went down for about 75 feet, and then it stopped at a given level.

"I found it necessary to forecast into the future for 10 or 12 years operation. We had to make sure we had ore enough uncovered of a proper grade, and all that kind of thing, to cover the period such as we could prepare for. In the conduct of the appropriation, it was necessary that I should make my estimates on from 10 to 12 years in the future.

164 "We would not have the same uncertain factors confronting us in estimating 12 years into the future that we would if we tried to go further into the future, because in the 10 or 12 years that you are dealing with—you are not trying to delimit, to set the final limits of your tonnage. For instance, in that property, you sometimes work five or six or seven or eight years, and you only lower yourself ~~25~~ feet, or maybe, at the most, 50 feet in that length of time; so there is a difference there between the estimate that an operator might make for the purpose of laying out his operations and an estimate that an individual is setting of the total tonnage in the property.

"'Q. Well, I will ask you other questions. You did consider it practical and feasible to attempt to forecast the future requirements of the ore for 10 or 12 years, did you?—A. Yes.

"'Q. Could you have gone as far as 15 years?—A. I suppose you might; yes.

"'Q. Well, what about 20 years?—A. Yes; I think you could have done that.

"'Q. What about 25 years?—A. Well, I don't know.

"'Q. You begin to get doubtful at 25 years?—A. I do.

"'Q. So that somewhere between 20 and 25 years, you think it is impractical to attempt to estimate the future requirements in ore?—A. Wait a minute, Mr. Mitchell. You are trying to lead me into something, and I am trying to tell you my story here the best way I can. Now, you asked me—you say, could you do it for 15

165 years; could you do it for 20 years? Think of the things that are involved in that. How do I know that this mine will not be producing 4,000,000 tons 15 years from now? It all depends upon the assumptions that I make.

"'Q. Well, is it not necessary?—A. The facts are—well, all right; you go ahead.

"'Q. Is it not necessary in the conduct of this business to make assumptions based on your very best judgment?—A. Yes; it is.'"

Upon redirect examination, J. C. Agnew further testified:

"Referring to my affidavit dated May 8, 1921 (Exihibt C), tracts 1, 2, 3, and 4, mentioned therein, did not contain all of the ore properties of this company as of 1916. There were about 10 forty-acre

tracts that were not contained in tracts 1, 2, 3, and 4. There had not been any exploration on those tracts to any appreciable extent. I don't think you could say there was none. I think there were a few tests, but nothing that you could call exploration. They were mineral lands, so acquired and so held by the company. As far as I know, nobody in 1916, or up to to-day, had any definite idea of the extent of ore under those properties that are not so included in this affidavit.

"Referring again to the same affidavit, and referring now in the same connection to Exhibit B, as to tract No. 1, I am to be understood as having said that all of these forties had been thoroughly explored, except the two extreme ones, and a little bit of one
166 of the others. Tract 2 is very well explored, I would say. Tract 1 is where the main operating property is located. As to tracts 3 and 4 the estimates contained in my affidavit are based on all the data that we could accumulate from adjoining properties, plus whatever information we could gain from the drilling. I think, as I recollect it, about two or three years after the tax commission took and changed the valuation of that property, we drilled a couple of those forties, about five holes to the forty, the idea being that we felt it would be unwise to continue to pay on such tonnage unless we could reasonably assume it was there. These 28 holes, coupled with the information that could be obtained from the outside, led us to believe that that estimate could not be lowered, and therefore we quit. I do not think we drilled all of those forties. That is my recollection. My recollection further is that there were some exploring operations carried on with respect to tracts 3 and 4 after 1916 and before this estimate in the affidavit of 1921. I am quite sure that the estimate of content as to tracts 3 and 4 is exactly the same as the Minnesota Tax Commission figures. That is where, I think, I got them originally; that is, the Tax Commission of Minnesota assigned a tonnage to each one of those forties. Of course we carried that along on our records, where they reported it to us every day, and we did this little drilling to find whether it was possible to refute any of these estimates, and we found it was not. We stopped drilling and, I think, those are the figures we used. I am pretty
167 certain of it. In speaking of refuting those estimates, I mean by that, whether they were too high.

"'Q. Now, referring to a part of this affidavit, respondent's Exhibit C, which you have read from, and concerning which Mr. Mitchell asked you some questions, from the information at hand as of March 1, 1913, you would estimate that tract No. 1 only could produce 2,300,000 tons for a period of 25 years, and so forth, that estimate having to do with the production. State whether or not that was made from an operating standpoint.—A. Well, yes; it was made—I was certain that it was possible for the property to do at least that, if I make myself clear, and I was not making a statement there that, in my judgment and to my knowledge of the property, it could not be performed.

"'Q. Now, in answer to one or two of Mr. Mitchell's recent questions as to the necessity of making estimates for a period of 10 or 12 years—I believe that is the expression used—state whether those estimates were made from an operating standpoint.—A. They were.

"'Mr. MITCHELL. Would you mind defining that a little bit more?

"'Mr. FORD. The capacity of the mine, rather than outside business conditions and all the other various elements.

"'Mr. MITCHELL. I see.'

"In making these 10-year and 12-year estimates, and in what I said in my affidavit, I took into consideration other factors besides mine capacity. I had to take into account two things.
168 One was the varying requirements of these stockholders, who might come and call on this property for a very large tonnage of ore, and occasionally as they did come in, in the middle of the summer, and change their minds and want the production stepped up. Then, I also had to take into account changes in their requirements as to grades of ore, which would involve mixing, and accessibility to the different parts of the mine where the different qualities of ore occurred. It was my duty as manager of that mine always to be ready for whatever they would ask for."

Upon recross-examination, J. C. Agnew testified as follows:

"In making my estimates, as set out in my affidavit, that the mine could produce 2,300,000 tons a year, I was not referring solely to the capacity of our mine when I made that statement. This statement was made up for depletion purposes, and I know there was considerable discussion of this proposition, as to how this depletion would be handled, what the tonnage would be, and all that kind of thing; and my recollection of it is that this 2,300,000 tons was arrived at in that way, taking into account what other people might want us to do and what the mine could do, and weighing all the various factors.

"It was not my best estimate of the probable future production. It is one estimate of the life of this mine, of the annual production of this mine. I have made estimates, as I told you, on various
169 bases, that I must be prepared to meet various demands for tonnage of the mine; the mine must always be prepared to do that. If that had been an estimate of the ultimate annual capacity of the mine, I expect I probably would have put down five or six million instead of 2,300,000, but I would not put it down for that length of time. If anybody had asked me what that mine could produce as of 1914, I could have said five or six million tons a year.

"'Q. There is just one thing that I want to get straightened out on. I understood you to say, referring to those eight forty-acre pieces that are in a row, that the middle six of those were susceptible of a reasonably accurate estimate of the ore content, and that the two end quarters were not. Did I understand you correctly?—A. Yes.

"'Q. Now, I want to call your attention to your testimony given in the hearing of the appeal of Julia Andrews Bruce.

"'Mr. TOMPKINS. What page?

"'By Mr. MITCHELL:

"'Q. On page 28 of that record, the last five lines of that page, and I ask you if you did not say that there was one forty which lies east of the six middle forties on which a reasonable estimate could be made?—A. That is in the record there, and if it is there, I probably said it.

"'Mr. FORD. Read after that, Mr. Mitchell.

"'Mr. MITCHELL. He is reading here——

170 "'Mr. FORD. Well let him read the testimony.

"'Mr. MITCHELL. Suppose you read your answer.

"'The WITNESS (reading):

"'Why, I would say that as to approximately the actual operating area for this purpose we will call six forties or 240 acres that was developed. There was one forty which lies east of the one there; I think a reasonable estimate could be made—forty to the west would be more in doubt. There was an additional 60-acre tract which lay not far from the present operation, where a reasonably accurate estimate could be obtained, but the rest of the property would be a matter of just judging.'

"'By Mr. MITCHELL:

"'Q. So, on your former testimony you said in effect, did you not, that the——A. If that is in the record, I said it.

"'Q. (Continuing.) That the east forty in the row of the eight forties was susceptible of a reasonable estimate of ore tonnage?—A. If that is in the record, I said it.'"

The foregoing was all of the evidence introduced on behalf of petitioner in this cause.

171 Respondent thereupon introduced certain evidence, as follows:

E. J. STACK, having first been duly sworn as a witness on behalf of respondent, on direct examination testified as follows:

"My name is E. J. Stack. I am a mining engineer, and I am employed by the Government as a valuation mining engineer. Including the time at college, I have been a mining engineer about twenty years. I valued properties on the Mesaba Range and other properties in the Lake Superior district ever since I have been with the Government. In fact, I have not done anything else but appraise properties in the Lake Superior district since 1922. I have traveled over the district, but once or twice I examined the different properties. I have examined and reported on ore mines owned and operated by Butler Brothers, Marquette Iron Company, the Hull Rust, and Mahoning properties, and some other smaller ones which I have forgotten. I personally examined the properties of the Mahoning Ore & Steel Company in 1925.

"'Q. Did you have any part in arriving at the commissioner's ore estimate of approximately 83,000,000 tons and a life of 45 years, as of March 11, 1916?

* * * * * * *

"'A. Well, I examined it, and I think in the spring of 1925 I made an appraisal. The ore estimate used in my appraisal
172 was identical with the one used in the present valuation. The life of the mine used in my appraisal was 42 years.'

"In finding the ore tonnage and the probable life of a mine such as the Mahoning mine, we estimate the ore reserves, and in computing the ore reserves we get all available data, such as drill records, underground development work, shafts, prospects, and so forth, and surface indications, together with any information that might be obtained from operations on the adjoining properties. We quite often refer to estimates by the State of Minnesota as a check against the estimates used in the unit, to verify our estimates. The investigations conducted by the State of Minnesota are considered among mining men very reliable as to the tonnages and the estimates of the ore reserves, but I do not know about their estimates as to the life of mines. I have no information about their estimates of probable life or their values. The Mahoning mine is one of the leading and largest iron-ore properties; that is, combined with the Hull Rust mine, it is one of the largest producers of iron ore in the country. That combined property comprises one big pit, about two miles long and three-quarters of a mile wide. I do not know of any active ore property in the world larger than that in 1916. There were some inactive, undeveloped ore regions. I would say that in 1916 it was the largest developed iron mine in the United States.

"The iron-ore formation on the Mesaba Range is a well-defined formation. At this particular occasion they have a well-
173 defined foot wall, regular, uniform foot wall, outcropping just north of the Mahoning tract No. 1, inclined at an angle of about 11 or 12 degrees, reaching a depth on the south side of this tract 1 of about a hundred feet; and underneath there is a sedimentary formation. Above this foot wall is the iron ore of very good grade; in fact, one of the best grades of iron ore in the United Statese, about 60 per cent iron and very low in phosphorus. Above the iron ore is the surface of overburden of glacial drift, varying from 5 to 20 or 30 feet thick.

"The method of mining typical in that neighborhood is strip mining. Drag lines and every form of steam shovel are used in removing that overburden. That is hauled away from the property, and the ore removed by the steam shovels.

"It is feasible to estimate the ore content. You can make a very accurate estimate of it. I would say the degree of accuracy obtained in estimating ore reserves in this property would be much higher than at any other mine that I know of, because of the geological conditions and the development of the drill

work, and the activity of adjacent properties. It is much easier to make a more accurate estimate of the Mahoning reserves than it is of others; because of mining conditions, the geological formation and the types and quality and character of the ore. Compared with the estimates of ore reserves in nonferrous metal mines, such as are found in Montana and Idaho—the estimate on the Mesaba Range was considerably more accurate. There is really no comparison. I do not know of any mining section on which it is easier to estimate the ore reserves than it is on the Mesaba.

"I am familiar with the book 'Report of the Minnesota Tax Commission, 1914,' and particularly the sections of that book dealing with Minnesota iron-ore properties. The sections of that book dealing with Minnesota iron-ore properties are regarded as authoritative scientific utterances."

Thereupon, attorney for respondent read from page 79 of said report the following:

"It was apparent to the commission that with the unusual character of the Mesaba ore deposits, being contained in detached rock basin of greater or less extent and covered by a glacial drift overburden of a few feet to not over 200 feet, it was only a matter of sufficient churn and diamond drilling, test pitting and other exploration and development work and a plotting of the result for each five feet of drilling, to calculate the quantity and grade of each layer of iron ore, and to obtain the total tonnage and its general average grade."

He further read from page 82 of said report, the following:

"Minnesota is especially fortunate in having its mineral wealth deposited in such form that it can be accurately measured and valued, and is probably the only state that has carefully measured the known iron-ore deposits, and is assessing such wealth on a strictly legal basis."

The witness then continued his testimony as follows:

"Except for the very last statement dealing with the method of assessing this wealth, I agree with the statements just read. I have no information one way or the other as to how Minnesota assesses this wealth, whether it is fairly done or otherwise. I think that the commissioner's estimate of a probable life of 45 years for this mine is a very accurate estimate as of March 11, 1916. As to the factors that enter into such an estimate, in underground mines, the physical capacity is quite important, but if it is a large open pit, it is not. There are other elements more important—economic conditions, especially in the steel industry, and the number of properties operated by the company operating this particular mine also has a very important bearing, together with the terms of the leases as compared with other leases, and the local conditions of this mine; that is, it may be to the operating company's advantage to curtail operations at one mine and increase them at another. I have knowl-

edge of several sales of iron-ore properties since March 1, 1913. The Meyers mine on the Mesaba Range was sold in 1917. The Kosmerl mine on the Mesaba was sold January 1, 1913. The Kosmerl mine was sold to the United States Steel Company. The owners received promissory notes payable over a term of years, about 30 or 40 years. I do not remember whether there was any cash
176 involved or not. Those notes were for fixed amounts, independent of the time. The total sale price was computed by estimating the ore reserves, multiplying that by the royalty rate, which was 25 cents, I think, or 40 cents—there were about 10,000,000 tons—and making the total sales price of about $4,000,000, to be received over a period of 40 years, in equal annual payments. The total sales price was based upon the estimates of ore content and probable life. That case was involved in a proceeding before this board. The name of the appeal was the Ruth Iron Mining Company. The Donora mine on the Mesaba was sold in April, 1913, on the same basis and the same terms as the Kosmerl sale, i. e., promissory notes, based on estimates of probable life and royalty rate existing under the lease. Higgins No. 1 and No. 2 were sold in 1917. The consideration for that sale was similar to the others. That was paid for again in promissory notes. Other sales were the Ray Prospect, Gilbert in 1917, and the Midway in 1913. I don't recollect just exactly how the consideration was arrived at for the first property. The sales price was arrived at in the same way, but I think the majority of these sales were based on ore estimates at the date of sale. I do not know of any iron properties sold where the sale price was fixed on any other basis than estimates of ore content and probable life. I regard the Kosmerl transaction as a typical transaction. Another mine that I did not mention is the Tener, which was sold in 1922. That is on the Mesaba Range also."

177 Upon cross-examination said E. J. Stack further testified:

"I did not say that the first trip I ever made out to this Mahoning property was in 1925. I said I examined the property at that time. I have been over the adjoining properties. 1925 was the only time I have been on that property.

"I had no part in fixing the valuation that the Commissioner of Internal Revenue arrived at in this particular case. I do not know whether there was any one year down to 1926 in which the Mahoning mine produced exactly 1,841,300 tons. The production varies very greatly from year to year. The annual production over the period from 1913 to 1926 fluctuated from year to year. When the commissioner estimated in this case that the life of this mine would be 45 years, that was based on the assumption that the mine would produce an average annual production of 1,841,000 tons.

"'Q. If the annual production, in fact, was not 1,841,000 tons, then the assumption as to a 45-year life would be changed, would it not?—A. Not necessarily.

"'Q. Not necessarily?—A. No, sir.

"'Mr. MITCHELL. You are speaking of the average production or the average annual production?

"'Mr. TOMPKINS. I am speaking of the fact, that if the mine produced, we will say, 500,000 tons or more annually, each year, you would have to assume a different life than 45 years from March 11, 1916.

178 "'The WITNESS. If the average annual production was any other than 1,841,000 tons, it would change the life, certainly.

"'By Mr. TOMPKINS:

"'Q. As a matter of fact, did the commissioner, in deciding these cases, have any expert make a personal examination of this Mahoning property, or did he not rely upon the figures which he had obtained from the Mahoning Company, and which had been used for purposes of fixing the depletion rate for that company?—A. That valuation was made before my time in the unit.

"'Q. You do not know anything about that?—A. No.

"'Q. Don't you know that since this case was decided by the Commissioner of Internal Revenue, the commissioner has fixed, in a depletion proceeding, a different life, a different annual production for this Mahoning mine than that upon which he decided this case?—A. As of the same basic date?

"'Q. Yes.—A. He did not; not to my knowledge.

"'Q. Not to your knowledge?—A. No.

"'Q. That appears in the stipulation. You referred here, Mr. Stack, to a number of sales of different ore properties made during the period from 1913 to 1917. As I understand it, in all those properties the prices which the purchasers were to pay for the properties was fixed, only the price was not paid in cash; it was

179 paid by a series of promissory notes, each for a fixed amount, and extending over a period which you say was estimated to be the life of the mine. Is that true?—A. Well, the sales price was arrived at by taking into consideration the estimated tonnage, the operating life and royalty rate. Now, whether those promissory notes extended over the same period, I could not say.'

I did not play any part in the negotiations leading up to those sales; I know nothing of them of my own knowledge. In most of them the sale price was fixed and definite and paid for by promissory notes.

"'Q. Do you know of any case in which stock in an ore company such as this—and I call your particular attention to the fact that I used the word "stock," not sale of ore property, but stock—was sold under a contract in which the total amount which the sellers would receive under the contract was not fixed but indefinite?—A. I do not recall any right now.

* * * * * * *

"'Q. Did you know, Mr. Stack, that of the mineral lands of the Mahoning Ore & Steel Company there were somewhere between three and four hundred acres that had not been valued at all?—A. Three or four hundred acres of undeveloped land.

"'Q. I beg your pardon?—A. Undeveloped land. We valued mineral land only.

"'Q. You did not value that land?—A. No.

"'Q. I see. Let me ask you another question, and then I will be through.

"'When you said you valued—what kind of land only?—A. Mineral.

180 "'Q. That is, you mean by that as to which complete exploration has been made?—A. Land which was known to contain minerals.

"'Q. Do you want to take the position that three or four hundred acres were known not to contain minerals?—A. No; I am not taking that position.

"'Q. Well, I just want to make it clear. By the term that you have used, by calling the other mineral land, I thought you meant to indicate this was not mineral land.—A. They were not referred to us for appraisals, because it was not known that they contained mineral as of that date.

"'Q. In other words, whether or not they contained mineral you do not know. Is that correct?—A. I do not.'

"The three or four hundred acres that I have referred to were on the Mesaba Range. I think a few of those 40-acre tracts were near the edge of the Mesaba Range, and some of them were toward the center.

"'Q. I say it has been testified to here that this Mahoning property, the property which is leased to the Mahoning Company, consisted of approximately slightly over a thousand acres of mineral land. You do not dispute that acreage, do you?—A. Not the acreage; no.

"'Q. Not the acreage; it has also been stipulated in this case that the commissioner, in arriving at his estimate as to the life of the mine and as to the ore reserves, based that estimate upon the
181 content of recoverable ore in only approximately 620 acres out of the entire property leased by the company, and, therefore that there must be four hundred and some acres in the property which had not been explored or taken into consideration in arriving at this estimate; is that true?—A. They were not included in that valuation.'"

Upon re-direct examination E. J. Stack further testified:

"The land on which the Government found mineral content is shown on Exhibit B. The Government did not find a mineral content for the remaining land which seems to be indicated on Exhibit A, because it has no record of any mineral on those tracts. The commissioner has no information whatever that they contained any mineral. They are unproven as far as mineral content is concerned.

"'Q. There has been some reference here to two appraisals by the commissioner. Are you familiar with the stipulation of facts which sets out those two appraisals?—A. Yes.

"'Q. It is true, is it not, that one of those appraisals was as of March 1, 1913, and the other one was as of March 11, 1916?—A. Yes, sir.

"'Q. The commissioner, as of March 1, 1913, estimated the probable life as 40 years, and as of March 11, 1916, as 45 years. Are those appraisals consistent or inconsistent?—A. I consider those two appraisals very consistent.

"'Q. Why do you say that?—A. Because they are made on
182 different basic dates, as of different basic dates. In each case, you had a different set of facts on which to base the valuation.'

"In the later appraisal you had additional history of three years to consider. The production for those three years was slightly less than 2,000,000 tons a year and during those three years the demand for iron ore was about the average."

Upon recross-examination said E. J. Stack further testified:

"I say the production of this mine for three years preceding 1916 was slightly under 2,000,000 tons a year. The production for 1913 was about 1,500,000 tons. For the year 1914 it was about 1,212,287 tons. For the year 1915 the stipulation in evidence shows that it was 2,311,940 tons."

H. L. PARRISH, having been first duly sworn as a witness on behalf of respondent, upon direct examination testified, as follows:

"My full name is H. L. Parrish. My occupation is valuation engineer in the Bureau of Internal Revenue. I am a mining engineer, and have been in the mining business, including the years in school and working, from 1910. I have been on the ore property mined by the Mahoning Ore & Steel Company a good many times. In 1923 I worked on it and am familiar with the property. I am also familiar in a general way with the Mesaba Range, particularly with that part of it around Hibbing, and also some of the portions
183 lying further east and further west. My work in 1923 was largely in the examination of and surveying of the open pit around the mines in various parts of the Mesaba Range. I know that the ore content of every mine on the Mesaba Range that I had any connection with had been very fully estimated. I am not so certain as to what the probable life of any particular property may have been. That would depend upon the program of the operator. It is practicable for one conversant with all the facts to make an estimate of probable life."

Upon cross-examination said H. L. Parrish further testified:

"Q. These estimated ore reserves of properties on the Mesaba Range you have testified to have been estimated for the purpose of fixing depletion rates for those companies up there, as required by law; is not that true?—A. Not always so; no, sir.

"Q. Not always so?—A. What estimates are you referring to?

"Q. You have testified here, in answer to Mr. Mitchell, that the ore reserves of most of those properties on the Mesaba Range have

been estimated and valued. Did you not testify to that?—A. I testified that they could be estimated and that they had been estimated; yes, sir.

"Q. And that they had been. As a matter of fact, all of them had been estimated for the purpose of fixing depletion rates for different companies; is not that true?—A. That is probably true, but I did not have that in mind in my answer.

184 "Q. And in order to fix those depletion rates, you have to make some estimate of the ore reserves; is not that true?—A. That is true; yes."

The foregoing testimony of E. J. Stack and H. L. Parrish was all the testimony introduced on behalf of respondent in this cause.

True and correct copies of all of the exhibits referred to in the testimony and proceedings, except such as are fully set forth herein, are transmitted herewith and made a part of the statement of evidence, as if fully set forth herein.

Thereupon counsel for petitioner and counsel for respondent stated that they had no further evidence to present and submitted the case to the member of the United States Board of Tax Appeals hearing the proceeding.

The petitioner, Edith Andrews Logan, tenders and presents the foregoing as a statement of the evidence in this case and prays that the same be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

CHARLES D. HAMEL,
MILLARD F. TOMPKINS,
JOHN ENRIETTO,
Attorneys for Petitioner,
906 Southern Building, Washington, D. C.

Approved and agreed to.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

185 Before United States Board of Tax Appeals

[Title omitted.]

Order approving narrative statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth and contains all of the evidence in said case in narrative form, the exceptions taken to rulings, and the proceedings had upon the trial of said cause. Where the testimony here is set forth in the form of questions and answers, it is so set forth that the evidence might be clearly understood.

It further appearing to the board that it is proper and necessary that certain exhibits, referred to in the statement of evidence and incorporated therein by reference, should be inspected by the United States Circuit Court of Appeals, it is hereby ordered that true and correct copies of said exhibits be transmitted by the clerk to said court in connection with the statement of evidence and transcript as follows

1. Respondent's Exhibit A, map showing location of Mahoning property.

186 2. Respondent's exhibit B, map prepared from descriptions of Minnesota authorities.

3. Respondent's Exhibit D, map of tracts 1, 2, 3, and 4.

Said statement of evidence on the petition for review of Edith Andrews Logan is hereby approved and signed and ordered to be made of record in the above-entitled cause this 30th day of September, 1929.

(S.) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

Now, October 3, 1929, the foregoing statement of evidence certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

187 Before United States Board of Tax Appeals

Filed September 27, 1929

[Title omitted.]

Præcipe for transcript of record

To the Clerk of the United States Board of Tax Appeals:

You will please prepare a transcript of record in this cause and on or before October 15, 1929, transmit the same to the clerk of the United States Circuit Court of Appeals for the Second Circuit and include in said transcript copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the board in the above-entitled cause.
2. Petition for redetermination.
3. Respondent's answer.
4. Findings of fact and opinion of the board, promulgated June 14, 1928.
5. Order of redetermination, entered June 15, 1928.
6. Agreement for review by the United States Circuit Court of Appeals for the Second Circuit, filed December 13, 1928.

188 7. Petition for review by the United States Circuit Court of Appeals for the Second Circuit, filed December 13, 1928.

8. Statement of Evidence.
9. This præcipe for transcript.

In addition to the foregoing documents, please transmit in connection with the transcript of record certified copies of orders enlarging the time for the transmission and delivery of documents in accordance with the rules of the United States Circuit Court of Appeals, which orders are dated, respectively, February 5, 1929, March 20, 1929, June 1, 1929, June 24, 1929, August 1, 1929, August 30, 1929, and September 16, 1929.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

CHARLES D. HAMEL,
JOHN ENRIETTO,
Attorneys for Petitioner.
C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

Now, October 3, 1929, the foregoing præcipe certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

189 In United States Circuit Court of Appeals, Second Circuit

EDITH ANDREWS LOGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order substituting party respondent

Nov. 14, 1929

Upon the annexed stipulation, it is ordered that this cause be, and it hereby is, reviewed in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and he hereby is substituted in this cause for the former Commissioner of Internal Revenue David H. Blair.

WM. PARKIN, *Clerk.*

190 In United States Circuit Court of Appeals

[Title omitted.]

Stipulation re substitution

It is hereby stipulated and agreed by and between the petitioner in the above-entitled cause and Robert H. Lucas, as Commissioner of Internal Revenue, through their respective attorneys, as follows:

That since the filing of the petition for review in the above-entitled cause David H. Blair, who was the respondent at that time in the above-entitled cause, and had been Commissioner of Internal Revenue since the appeal was originally filed in the United States Board of Tax Appeals at Washington, D. C., has resigned as said Commissioner of Internal Revenue, and his resignation has been duly accepted.

That David H. Blair ceased to be Commissioner of Internal Revenue on the 31st day of May, 1929.

That Robert H. Lucas was duly appointed as Commissioner of Internal Revenue to succeed the said David H. Blair and has duly qualified as said Commissioner of Internal Revenue.

That on June 1, 1929, said Robert H. Lucas became Commissioner of Internal Revenue and ever since that time has been, and now is, Commissioner of Internal Revenue.

It is stipulated and agreed between the petitioner in the above-entitled cause and Robert H. Lucas, as Commissioner of Internal Revenue, through their respective attorneys, that agreeably to this court, and in accordance with the law, this cause may be revived so that this action will be pending against the said Robert H. Lucas, as Commissioner of Internal Revenue, and that said Robert H. Lucas,
191 as Commissioner of Internal Revenue, may be substituted as the respondent in this cause for the said David H. Blair, formerly Commissioner of Internal Revenue.

That there is substantial need for so continuing and maintaining this cause, because if it is not so continued and maintained the order of the United States Board of Tax Appeals, for the review of which the petition for review in this cause was filed, will become final; the tax found by the said Board of Tax Appeals to be due will be assessed and collected from this petitioner without recourse to further contest its legality, or obtain a refund thereof.

It is further stipulated and agreed by and between the petitioner in the above-entitled cause and Robert H. Lucas, as Commissioner of Internal Revenue, through their respective attorneys, that the service of notice of the motion to revive this action in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and to have his name substituted as respondent in this cause, is hereby waived, and the said Robert H. Lucas, as Commissioner of Internal Revenue, by and through his attorney, consents that an order may be made forthwith by the court reviving this cause in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and substituting him as respondent in this cause for the former Commissioner of Internal Revenue, David H. Blair.

MILLARD F. TOMPKINS,
Attorney for Petitioner.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue,
Attorney for Robert H. Lucas, as
Commissioner of Internal Revenue.

192 In United States Circuit Court of Appeals for the Second Circuit

No. 214. October term, 1929

Argued April 16, 1930. Decided May 19, 1930

EDITH ANDREWS LOGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Before MANTON, SWAN, and AUGUSTUS N. HAND, Circuit Judges

Opinion

Petition to review an order of the United States Board of Tax Appeals. Determination of deficiencies in the income taxes of the taxpayer for the years 1918, 1919, and 1920 were affirmed by the board. The taxpayer appeals. Order reversed.

Millard F. Tompkins, of New York City (John Enrietto, of Washington, D. C., and Herbert C. Smyth, of New York City, of counsel), for petitioner.

G. A. Youngquist, Asst. Atty. Gen., and J. Louis Monarch and John Vaughan Groner, Sp. Assts. to Atty. Gen. (C. M. Charest, Gen. Counsel, Bureau of Internal Revenue, and Allin H. Pierce, Sp. Atty. Bureau of Internal Revenue, both of Washington, D. C., of counsel), for respondent.

MANTON, Circuit Judge:

Prior to March 1, 1913, and until March 11, 1916, the petitioner owned 250 shares, and her mother 1,180 shares of the stock of the Andrews & Hitchcock Iron Company, which had, as its capital structure, 4,000 shares of capital stock issued and outstanding. Andrews & Hitchcock Iron Company held a 12 per cent stock interest in the Mahoning Ore & Steel Company. This latter company controlled, by a lease of 97 years from April, 1895, an iron-ore mine—the Mahoning Mine—located on the Mesaba Range in Minnesota. It was an operating company, and mined the ore which it distributed only to its stockholders, who were steel manufacturers. The property consisted of 1,000 acres of mineral land, and it was estimated that it contained on October 11, 1916, 82,858,535 tons of ore.

On March 11, 1916, the Youngstown Sheet & Tube Company purchased all the outstanding capital stock of the Andrews & Hitchcock Company, thus acquiring the 12 per cent stock interest of the ore mined by the Mahoning Company. In the purchase of this stock it was paid $2,200,000 in cash, and in addition it obtained a contract by which all the former stockholders were paid 60 cents per

ton for each and every ton of iron ore which it might thereafter become entitled to receive from the Mahoning Company under the contract between it and the Mahoning Company. Payments were made annually, and all the transferred stock in the Mahoning Company was deposited as collateral security. Petitioner thus acquired a 250/4000 interest in this contract for annual payments, and when her mother died she acquired, by bequest from her estate, an additional 550/4000 interest in the contract.

Payments were made to the petitioner on account of this contract by reason of her interest therein, and respondent has held this was part capital return and part income as to the sums received in the years in question, 1918, 1919, and 1920. This resulted in the imposition of the tax which is here in dispute. In arriving at this result the respondent determined that the total consideration received by the stockholders from the sale of their stock to the Youngstown Sheet & Tube Company on March 11, 1922, was $2,200,000
193 in cash and $1,942,111.46, the fair market value of the contract providing for payments as stated. And in determining such fair market value he estimated the total ore reserves in the Mahoning mine to be 82,858,535 tons, the average annual production to be 1,841,300 tons, and the life of the mine to be 45 years, and the total future receipts from the contract to be $5,965,814.52. This result was reached by computing the present fair value, using the Haskold formula.

The respondent determined that the total of this consideration was more than the cost of the stock sold but less than its March 1, 1913, value, and he decided that no taxable income had been derived from the sale when made. However, with respect to annual payments from the contract he determined that each payment should be regarded as part income and part capital return. He found the total amount of capital to be recovered was the fair market value of the contract at the time of its acquisition, and he divided each annual payment as between capital and income in the same proportions as the total capital to be recovered bore to the total anticipated receipts included in the gross income of each former stockholder the entire amount received by him during each year, and he allowed as a deduction therefrom the sum which he determined to be a capital return. As to this petitioner's interest, which she acquired from her mother's estate, he determined that the total amount of capital to be allowed was the fair market value of the interest at the time of the decedent's death and permitted capital to be recovered through apportionment of the annual payments as prescribed. He found the return each year to be 32½ per cent capital return and 67½ per cent income.

The revenue act of 1918, c. 18 (40 Stat. 1057), provides, in section 210, the normal tax upon the net income of every individual in the taxable year; section 211 in addition to the normal income, a surtax; section 212 defines net income as the gross income less deduc-

tions defined in sections 213, 214; section 213 (a) considers gross income and includes "gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." And section 214 (a) considers allowable deductions and provides:

"(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

"(10) In the case of mines, oil and gas wells, * * * a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted. * * *"

Section 202 (a) provides:

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and (2) In the case of property acquired on or after that date, the cost thereof; * * * (b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any. * * *"

At the time Regulation 45, relative to the revenue act of 1918, was effective, and it provided that taxpayers be allowed a deduction in computing net income in cases of natural deposits, a reasonable allowance for depletion of mineral and other depreciations of improvements; that the fair market value of a property was that amount which indues a willing seller to sell and a willing buyer to purchase. Where there has been no sale and the fair market value at the basic date is to be used, such value will be determined by the method which the prospective buyer or seller in the industry would use in arriving at the sale value of the property at the basic date. And article 206 of the regulation provides the method of determining the fair market value of mineral property. Article 210 provides the computation of deduction for depletion of mineral deposits, and by it (a) depletion attaches to the annual production "according to the peculiar conditions of each case. * * *" (b) When the value of the property at the basic date has been determined, depletion for the taxable year shall be determined by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multi-
194 plying the unit value for depletion, so determined, by the number of units sold within the taxable year. In the selection of a unit for depletion, preference shall be given to the principal or customary unit or units paid for in the product sold.

The valuation placed on the contract for the stockholders' benefit, giving them 60 cents a ton in this case, together with cash paid in the sale, showed no gain over March 1, 1913, valuation, and there was no income tax payable in 1916. However, on the theory that there was a gain involved in the future obligations during the period of 45 years, the tax was imposed by determining, in the manner referred to, that each annual payment was part capital and part income. Income is declared and taxes imposed where cash is paid in a sale or where the thing received is capable of easy valuation in cash. (Lynch v. Turrish (1918), 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087; Safe Deposit & Trust Co. v. Miles (D. C. 1921), 273 F. 822.) Where the consideration received is found to be the equivalent of cash, it may be valued, and if a profit is realized it will be taxed. (Marr v. United States (1925), 268 U. S. 536, 45 S. Ct. 575, 69 L. Ed. 1079.) Before income can be derived there must be not only some value to the consideration, but it must have an established or fair market value; it must be the equivalent of cash. (Bedell v. Commissioner (C. C. A. 2, 1929), 30 F. (2d) 622; section 202 (b), revenue act of 1918 (40 Stat. 1060).)

There were many uncertainties involved in the future receipt of 60 cents a ton by this petitioner. She, a minority stockholder, was not in control. The right to continue to receive ore was dependent on the continuance in force of the contract of December 16, 1914, between the stockholders of the Mahoning Company. That contract might be abrogated or changed. No maximum or minimum payment is provided for by the contract. The tonnage mined each year was subject to the discretion of the board of directors of the Mahoning Company. The ore mined each year in the future might not come up to the production estimated as necessary to exhaust the mine in 45 years. In enforcing this taxing statute a plain, obvious, and rational meaning is to be preferred. (Lynch v. Alworth-Stephens Co. (1925), 267 U. S. 364, 45 S. Ct. 274, 69 L. Ed. 660.) There was ample testimony satisfactorily establishing that there was no market for the sale of the obligation to pay the 60 cents per ton for 45 years, and it had no cash equivalent. Congress, by the phrase "fair market value" meant that not only must the market price be ascertained by sales, but sales so made and the circumstances under which they were made were to be considered to determine whether such sales serve to evidence not alone a market sale but the fair price which Congress said should be the satisfactory start or base from which subsequent gain derived should be determined. (Walter v. Duffy (C. C. A. 3, 1923), 287 F. 41.) It was the intention of Congress to provide a method of determining gain or loss when property is exchanged for other property, and under the statute there is no taxable gain and no deductible loss unless the property received has a value realizable in money's worth. (Tsivoglou v. United States (D. C. 1928), 27 F. (2d) 564; Heiner v. Crosby (C. C. A. 3d, 1928), 24 F. (2d) 191.) And where the right to receive

moneys is contingent as provided by a contract until the property right secured by the contract has been relieved of its element of risk and turned into cash, the income-taxing act does not reach it, and the contingent right is not income. (Woods v. Lewellyn (C. C. A. 3d, 1918), 252 F. 106.) Cases like Kosmerl v. Commissioner (C. C. A. 7th, 1928), 25 F. (2d) 87; Ruth Iron Co. v. Commissioner (C. C. A. 8th, 1928), 26 F. (2d) 30; and Eldredge v. United States, 31 F. (2d) 924 (C. C. A. 6th), involved efforts to determine gain or loss on the sale of property and the determination of its March 1, 1913, valuation. They did not involve a question, as here, of whether a promise to pay in the future a sum of money in consideration of the transfer of stock has a present market value for determination of gain before the promise is fulfilled. The question in those cases was one of ascertaining the value of the rights as of March 1, 1913, to future annual payments, which value, the taxing statute requires, should be returned before any part of the latter conversion into cash could be considered as income. The necessity of this determination arises only after there has been a gain derived, and the March 1, 1913, valuation is necessary to apportion that gain between the gain accrued prior to and that accrued subsequent to March 1, 1913. (Lucas v. Alexander (1929), 279 U. S. 573, 49 S. Ct. 426, 73 L. Ed. 851, 61 A. L. R. 906.) Here we have the question of whether there was any gain.

The estimate of recoverable tonnage of ore is very much in
195 dispute; likewise the annual production and period of years estimated to complete the mining. Indeed, witnesses familar with the mine and its operation and interested therein and qualified to speak gave testimony that the promise to make future payments had no ascertainable market value. As stated by a learned author, in the practical conduct of mines or mining, sinking funds for amortization of capital are never established. The ultimate duration of the life of a mine is uncertain or unknown and forms no basis on which to formulate a definite financial policy. (Hoover's Principles of Mining, p. 44. See also Pacific Gas Co. v. San Francisco (1924), 265 U. S. 403, 44 S. Ct. 537, 68 L. Ed. 1075.) Moreover, the division of percentage as a return of capital and that of income is an estimate based upon assumptions and uncertainties. It is an unsafe guide either to determine exchangeable value or the fair market value. (O'Meara v. Commissioner (C. C. A. 10th, 1929), 34 F. (2d) 390.)

It is necessary that the future payments made to the stockholders of the Andrews & Hitchcock Company amount to $1,942,111.46 before the petitioner will have a full return of her capital. Until the petitioner receives her full share of this capital return—the exchangeable or fair market value in 1916—she will receive no income, but a return of her capital as deferred payments. There will be no gain or loss realized in the 1916 transaction until this sum is returned to her. As to the shares inherited from her mother's estate, the value of the capital return will be the value of such interest at the time of her mother's death.

The respondent's determination deprived the petitioner of the benefit of that part of the March 1, 1913, value which is greater than the consideration received, to the extent to which the March 1, 1913, value exceeded $2,200,000 plus the present value estimate of the promise to pay as $1,942,101.46. When he ascertained the gain from the subsequent conversion or the disposition of the contract right to receive future payments, he did not give credit to the taxpayer for any March 1, 1913, value, but began the base anew on the theory that the contract right to receive payments when reduced to cash is partly a return of contract right and partly income. In Doyle v. Mitchell Bros. Co. (1918) (247 U. S. 179, at page 185, 38 S. Ct. 467, 469, 62 L. Ed. 1054) the court said: "In order to determine whether there has been gain or loss, and the amount of the gain if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." (See also Goodrich v. Edwards (1921), 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758; Mastin v. Commissioner, 28 F. (2d) 748 (C. C. A. 8th); United States v. Guinzburg (C. C. A. 2d, 1921), 278 F. 363.) The commissioner may not create income by spelling out paper profits with all the attending uncertainties which exist here and which might prevent the return of capital. The statute and the regulation referring to depletion of the mines, we think, have no application to this petitioner.

In his calculations the respondent, being guided by the Haskold formula, has in effect determined that the contract of March 11, 1916, by which the stockholders of the Andrews & Hitchcock Company received these benefits, constitutes a right to annual payments fixed by accepting the tonnage thought to be in the mine, the annual mining operations, the length of time necessary for exhaustion, and the price paid for the ore mined, and this amounted to $132,573.60 annually to be paid to the vendors of the stock. If all went well each year, and the mining operation was the same with the same degree of fortune as to the quantity and quality of the ore mined, there would be insured to the stockholders this annual payment. In effect it would be similar to an annuity. Therefore when this taxpayer sold her stock, in addition to receiving cash, she would obtain what substantially amounts to an annuity for a period of 45 years. If this were a purchase of an annuity, the sums received in the years in question could not be taxed as income. (Warner v. Walsh (C. C. A. 2, 1926), 15 F. (2d) 367.) The same principle is applicable. (United States v. Bolster (C. C. A. 1, 1928), 26 F. (2d) 760, 59 A. L. R. 491; Allen v. Brandeis (C. C. A. 8, 1928), 29 F. (2d) 363.)

There is no taxable income received until there has been a return of petitioner's capital, ascertained by finding her proportionate share of the value of her original 250 shares as of March 1, 1913, and as to those shares inherited from her mother's estate, the value of such interest at the time of her mother's death.

Order reversed.

196 In United States Circuit Court of Appeals, Second Circuit

EDITH ANDREWS LOGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed May 26, 1930

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed.

It is further ordered that a mandate issue to the said board in accordance with this decree.

WM. PARKIN, *Clerk.*

197 [File indorsement omitted.]

198 [Clerk's certificate to foregoing transcript omitted in printing.]

199 In Supreme Court of the United States

Order extending time within which to apply for writs of certiorari.

Filed August 27, 1930

On consideration of the motion of counsel for petitioner in the above-entitled cases, and good cause therefor having been shown, it is now here ordered that the time within which petition for writs of certiorari may be filed herein be, and the same is hereby, extended for a period of sixty days from this date.

Dated this 22d day of August, 1930.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

[File endorsement omitted.]

U. S. GOVERNMENT PRINTING OFFICE: 1930

Supreme Court of the United States

Order allowing certiorari

Filed December 1, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

CLERK'S COP

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 522

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JULIA ANDREWS BRUCE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 21, 1930
CERTIORARI GRANTED DECEMBER 1, 1930

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 522

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JULIA ANDREWS-BRUCE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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Before U. S. Board of Tax Appeals

Docket No. 18202

JULIA ANDREWS BRUCE, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

For taxpayer: Walter M. Anderson, Esq.; Chas. D. Hamel, Esq.; R. B. Goodell, Esq.
For commissioner: L. C. Mitchell, Esq.

Docket entries.

1926
July 3—Petition received and filed.
" 6—Copy of petition served on solicitor.
" 6—Notification of receipt mailed taxpayer.
Sept. 4—Answer filed by Gen. Counsel.
" 9—Copy of answer served on taxpayer. General Cal.
1927
Mar. 22—Hearing date set 5-16-27.
May 3—Motion for a continuance until 9-12-27 filed by taxpayer.
" 7—Granted to Oct. 12, 1927. Both sides notified.
Sept. 22—Order changing hearing date to 11-8-27. Signed & filed. Both sides notified.
Nov. 7—Motion to continue to 1-10-28 or thereafter, filed by taxpayer. Granted to Jan. 17, 1928.
1928
Jan. 17—Hearing had before Mr. Smith on merits. Stipulation of facts filed. Briefs due in 60 days. No exchange.
2 Mar. 9—Brief and findings filed by taxpayer. See 5916.
" 14—Brief filed by G. C. See 5508.
June 14—Findings of fact and opinion rendered.
" 15—Order of redetermination entered.
Dec. 7—Supersedeas bond for $35,000, approved and ordered filed.
" 13—Petition for review by U. S. Cir. Ct. of App. (2d) with assignments of error filed by taxpayer.
" 13—Proof of service filed.
1929
Feb. 15—Agreed motion to enlarge time to 4/1/29 to prepare evidence and transmit record filed.
" 15—Notice of appearance of Chas. D. Hamel & Raymond B. Goodell as counsel for taxpayer filed.
" 13—Order enlarging time to 4-1-29 for preparation of evidence
" and delivery of record entered.

1929

Mar. 19—Motion to enlarge time to 6–1–29 for preparation of evidence and delivery of record filed by G. C.

" 20—Order enlarging time to 6–1–29 for preparation of evidence and delivery of records, entered.

May 29—Motion for extension to July 1, 1929, to prepare statement of evidence and transmit record, with proof of service thereon, filed by G. C.

" 31—Order enlarging time to July 1, 1929, for preparation of evidence and delivery of records, entered.

3 June 21—Motion for extension to Aug. 1, 1929, to file statement of evidence and transmit record, filed by taxpayer.

" 24—Order enlarging time to 8–1–29 to file statement of evidence and transmit record, entered.

Aug. 1—Motion for enlarging time to 8–31–29 to file statement of evidence and transmit record filed by taxpayer.

" 1—Order enlarging time to 8–31–29 to prepare evidence and transmit record, entered.

" 27—Transcript of hearing of Aug. 16, 1929, filed.

" 29—Motion for extension to Sept. 15, 1929, to file statement of evidence and transmit record, filed by taxpayer.

" 30—Order enlarging time to Sept. 16, 1929, for preparation of evidence and transmission of record, entered.

Sept. 14—Motion for extension to Oct. 15, 1929, to file statement of evidence and transmit record, filed by taxpayer.

" 16—Order enlarging time to Oct. 15, 1929, for prepa'tion of evidence and delivery of record, entered.

" 27—Agreed statement of evidence lodged.

" 30—Agreed statement of evidence approved and ordered filed.

" 27—Agreed præcipe filed.

Now, October 3, 1929, the foregoing docket entries certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

4 Before United States Board of Tax Appeals

[Title omitted.]

Petition

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:PA:PYA:ARM, dated May 8, 1926, and as the basis of her proceeding alleges as follows:

(1) The petitioner is a resident citizen of the United States, whose address is North Street, Greenwich, Connecticut.

(2) The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on May 8, 1926.

(3) The taxes in controversy are income taxes for the calendar years 1918 and 1919, and are more than $10,000.00, to wit, $20,705.12.

(4) The determination of tax contained in the notice of deficiency is based upon the following errors:

5 (a) The commissioner erred in adding to the net income reported in the returns filed by the petitioner for the years 1918 and 1919 the sums of $10,623.38 and $21,733.85, respectively, under the general and erroneous description "ore payments from the Youngstown Sheet & Tube Company less return of capital thereon" and in adding to net income reported in the returns filed by the petitioner for the years 1918 and 1919 any sums whatever in respect of the transaction so described.

(b) The commissioner erred in treating as taxable income for the years 1918 and 1919 any portion of the sums of $15,750.00 and $32,383.80, respectively, received by the petitioner during those years as part of the sale price of shares of stock in the Andrews and Hitchcock Iron Company which were sold during the year 1916.

(5) The facts upon which the petitioner relies as the basis of her appeal are as follows:

(a) Prior to March 1, 1913, and continuously to March 11, 1916, the petitioner owned 350 shares of the capital stock of the Andrews and Hitchcock Iron Company, the value of which at March 1, 1913, exceeded the cost of the shares to the petitioner.

(b) At March 11, 1916, the outstanding stock of the Andrews and Hitchcock Iron Company consisted of 4,000 shares.

6 (c) On March 11, 1916, the stockholders of the Andrews and Hitchcock Iron Company sold to the Youngstown Sheet & Tube Company for $2,200,000.00 in cash and a sum to be thereafter paid equal to 60¢ per ton of iron ore to the delivery of which from the Mahoning Ore & Steel Company, the Youngstown Sheet & Tube Company should thereafter be entitled as an incident of the ownership by the Andrews and Hitchcock Iron Company of one-twelfth of the capital stock of the Mahoning Ore & Steel Company, the payments to be made annually on the basis of the ore to the delivery of which the Youngstown Sheet & Tube Company should become entitled during each year.

(d) Prior to March 1, 1913, and continuously to March 11, 1916, Louisa Andrews, mother of the petitioner, owned 1,100 shares of the capital stock of the Andrews and Hitchcock Iron Company, which shares were sold in 1916, as above set forth, and by a bequest in the will of said Louisa Andrews the petitioner received a one-half interest in the estate and became entitled to receive 550/4000ths of the unpaid purchase price at the date of her mother's decease, which occurred March 22, 1917.

(e) During the years 1918 and 1919 the petitioner received as part of the sale price $15,750.00 and $32,383.80, respectively.

7 (f) The aggregate sum of the amounts received by the petitioner prior to December 31, 1919, as part payment of the sale

price of the 350 shares owned prior to March 11, 1916, including her share of the consideration of $2,200,000.00 in cash paid in 1916, was less than the value at March 1, 1913, of said 350 shares.

(g) The aggregate sum of the amounts received by the petitioner prior to December 31, 1919, in respect of the unpaid sale price at the date of her mother's decease was less than the value fixed upon her interest for the purpose of the Federal estate tax.

(h) The petitioner keeps no books and the returns of the petitioner for the years 1916, 1917, and 1918 were made upon the basis of cash receipts and disbursements.

(6) The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

(a) The petitioner asks that the board find the Commission of Internal Revenue erroneously added to the net income reported by the petitioner in her returns for the years 1918 and 1919, the sums of $10,623.38 and $21,733.85, respectively, under the description "Ore payments from the Youngstown Sheet & Tube Company, less
8 return of capital thereon," and that no part of said sums so added by the Commissioner of Internal Revenue to the petitioner's net income for the taxable years 1918 and 1919, constituted income taxable to her in those years.

Wherefore the petitioner prays that this board may hear and determine the deficiency herein alleged.

WALTER M. ANDERSON,
Counsel for the petitioner.
WALTER M. ANDERSON,
Greenwich, Connecticut.

JULY 1ST, 1926.

[*Duly sworn to by Julia Andrews Bruce; jurat omitted in printing.*]

9 *Exhibit A to petition*

TREASURY DEPARTMENT,
Washington, D. C., May 8th, 1926.

IT:PA:PYA
ARM
MRS. JULIA ANDREWS BRUCE,
North Street, Greenwich, Conn.:

Your claims for abatement of a deficiency in tax amounting to $20,705.12 assessed against you for the taxable years 1918 and 1919 has been carefully considered by this office, and it is proposed to reject the said claims for $20,705.12 as computed upon the enclosed statement.

In accordance with the provisions of section 283 (e) or section 283 (k) of the revenue act of 1926, you are allowed 60 days (not counting Sunday as the sixtieth day) from the date of mailing of this letter within which to file a petition with the United States

Board of Tax Appeals, Earle Building, Washingon, D. C., contesting in whole or in part the correctness of this determination.

If you acquiesce in this determination and do not desire to file such petition, you are requested to execute waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA:
10 PYA:ARM:60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.
By C. R. NASH,
Assistant to the Commissioner.

Enclosures:
Statement
Waiver—Form A.

Statement

IT:PA:PYA
ARM

In re: Mrs. Julia Andrews Bruce, North Street, Greenwich, Conn.

Year	Deficiency in tax
1918	$9,419.61
1919	11,285.51
	20,705.12

In accordance with the recommendation of the solicitor, your interest in the Andrews-Hitchcock Iron Company was adjusted by providing a sinking fund of 4% instead of 6%, which in your case shows a present new worth of $169,934.73 in lieu of $179,289.13.

11 The deferred payments for purposes of tax were allocated as follows:

Of every dollar received, represented by the 350/4000 interest, $0.32554 represents a return of capital and $0.67446 constitutes capital income. Of every dollar received represented by the 550/4000 interest acquired by inheritance, $0.33099 represents a return of capital and $0.66901 constitutes taxable income.

1918

The depletion sustained in 1918 amounts to $5,126.62.

You are advised that the profit of $17,600.00 from the exchange of stock of the Pittsburgh Coal Company of New Jersey for stock of the Pittsburgh Coal Company of Pennsylvania was eliminated from the 1918 return.

The revised net income for 1918 is $72,787.85.

1919

The depletion sustained in 1919 amounts to $10,649.95. The revised net income for 1919 is $93,975.45.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district and remittance should then be made to him.

Now, October 3, 1929, the foregoing petition certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

12 Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Sept. 4, 1926

The Commissioner of Internal Revenue, by his attorney A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. Admits that the commissioner made the adjustments as alleged in paragraph 4 of the petition.

5 (a) and (b). Admits the material allegations of fact contained in paragraphs 5 (a) and (b) of the petition.

13 5 (c) to (h). Denies the material allegation of fact contained in paragraphs 5 (d) to (h) of the petition.

Denies each and every other material allegation of fact contained in the petition.

Wherefore, it is prayed that the commissioner's determination be approved and that the petition be dismissed and the appeal denied.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of counsel:

A. H. FAST, *Special Attorney, Bureau of Internal Revenue.*

Now, October 3, 1929, the foregoing answer certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

14 Before United States Board of Tax Appeals

EDITH ANDREWS LOGAN ET AL.,* PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 5508, 5916, 5917, 5918, 6014, 6436, 6437, 6438, 18202.
Promulgated June 14, 1928

Findings of fact and opinion

1. Petitioners sold stock on March 11, 1916, for more than cost and for more than the March 1, 1913, value. A part of the consideration received was a contract providing for future payments as ore was mined. The contents and life of the mine and the annual production were capable of determination. Held, that the contract received had a determinable fair market value at the date of receipt.

15 2. Deferred payments under the contract were based upon the number of tons mined annually from the Mahoning mine, the mineral content of which was susceptible of accurate determination; held, that such portion of the deferred payments received during each year as the number of tons mined during such year bears to the total determined content of the mine constitutes a return of principal and that the balance constitutes a receipt of taxable income.

John W. Ford, Esq., Millard F. Tompkins, Esq., and Walter M. Anderson, Esq., for the petitioners.

L. C. Mitchell, Esq., for the respondent.

These proceedings are for the redetermination of deficiencies in income tax, as follows:

	Year	Deficiency	Overassessment
Edith Andrews Logan, Docket No. 5508:			
(Claim filed)	1915		$18.60
" "	1916		1,441.15
" "	1917		491.73
	1918	$994.05	
	1919	14,277.92	
	1920	6,776.66	
		22,048.63	1,951.48
Henry W. Heedy, Docket No. 5916	1918	424.38	
	1919	291.67	
	1920	272.21	
		988.26	

* The following proceedings were heard with the above and are decided herewith:
Henry W. Heedy, Docket No. 5916.
William J. Hitchcock, Docket No. 5917.
Frank Hitchcock, Docket No. 5918.
William M. Andrews, Docket No. 6014.
Carrie L. Shaw, executrix of the estate of John Shaw, deceased, Docket Nos. 6436, 6437, and 3438.
Julia Andrews Bruce, Docket No. 18202.

	Year	Deficiency	Overassessment
William J. Hitchcock, Docket No. 5917	1918	$7,907.60	
	1919	3,024.06	
	1920	3,144.05	
		14,135.71	
16 Frank Hitchcock, Docket No. 5918	1918	8,483.14	
	1919	4,889.75	
	1920	1,701.20	
		15,074.09	
William M. Andrews, Docket No. 6014	1918	135.80	
	1919	71.19	
	1920	46.76	
		253.75	
Carrie L. Shaw, executrix of the estate of John Shaw, deceased, Docket Nos. 6436, 6437, 6438	1918	518.60	
	1919	147.47	
	1920	77.25	
		743.32	
Julia Andrews Bruce, Docket No. 18202	1918	9,419.61	
	1919	11,286.51	
		20,706.12	

These proceedings were consolidated for hearing and decision. The allegations of error in the several petitions are substantially the same, and are that the commissioner erred (1) in adding certain amounts to the net income reported in the returns filed by the petitioners for the years in question under the general and erroneous description "ore payments received from the Youngstown Sheet & Tube Company, less returns of capital thereon," and in adding to net income reported in the returns filed for the taxable years any sums whatever in respect of the transactions so described; and (2) in treating as taxable income for the taxable years any portion of the sums received by the petitioners during those years as part of the sale price of shares of stock in the Andrews & Hitchcock Iron Company which were sold during the year 1916.

17 FINDINGS OF FACT

1. The petitioners are all citizens of the United States and residents of Youngstown, Ohio, except Julia Andrews Bruce, who is a resident of Greenwich, Connecticut.

2. Prior to March 1, 1913, and continuously to March 11, 1916, Edith Andrews Logan owned 250 shares; her mother, Louisa Andrews, owned 1,180 shares; Henry W. Heedy, 100 shares; William J. Hitchcock, 1,000 shares; Frank Hitchcock, 1,000 shares; the Cleveland Trust Company, trustee for the three children of U. A. Andrews (of which William M. Andrews was one), 120 shares; and Julia Andrews Bruce, 350 shares; constituting all of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which at all said times mentioned had 4,000 shares of capital stock issued and outstanding.

3. The Andrews & Hitchcock Iron Company at all times between March 1, 1913, and March 11, 1916, owned, among other assets, a 12 per cent interest in the capital stock of the Mahoning Ore & Steel Company, which controlled under a lease dated April 1, 1895, and running for 97 years after said date, an iron mine located on the Mesaba Range in Minnesota, known as the Mahoning mine.

4. On March 11, 1916, all the stockholders of the Andrews &
18 Hitchcock Iron Company entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, providing for the sale of their stock in the Andrews & Hitchcock Iron Company to the Youngstown Sheet & Tube Company, the material portions of which contract are set forth in the findings of fact in Julia Andrews Bruce and Edith Andrews Logan, executrix, estate of Louisa Andrews, 5 B. T. A. 300. This contract made reference to a written contract dated December 16, 1914, by and between the stockholders of the Mahoning Ore & Steel Company, the material portion of which is also set forth in the findings of fact in the case of Julia Andrews Bruce et al., supra.

5. Under the said contract of March 11, 1916, the Youngstown Sheet & Tube Company paid for all the outstanding stock of the Andrews & Hitchcock Iron Company the sum of two million two hundred thousand ($2,200,000.00) dollars in cash and further covenanted and agreed to and with the vendors of said stocks as additional consideration for the said stock, as follows:

"Fourth. It is understood that said the Andrews & Hitchcock Iron Company is the owner of twelve per cent or three hundred sixty (360) shares of the capital stock of the Mahoning Ore & Steel Company, a corporation of the State of Pennsylvania, having a capital stock of three hundred thousand dollars ($300,000.00) divided
19 into three thousand (3,000) shares of the par value of one hundred dollars ($100.00) each, which said Ore and Steel Company is the owner of certain valuable mines for the production of iron ore, and that the said the Andrews & Hitchcock Iron Company, by an agreement in writing in quintuplicate bearing date of December 16th, 1914, is entitled to take each year a full quota of each grade of ore to be produced by said Ore & Steel Company in proportion to the amount of stock owned by or represented for it, as provided for in said agreement, a copy of which is hereto attached and marked 'Exhibit A' for the purpose of making the same a part hereof; and for the purpose of fixing the balance of the purchase price to be paid by the Youngstown Company, it is therefore further agreed between said parties as follows, to wit:

"'That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of ore to which the said the Andrews & Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the terms of said written agreement of December 16, 1914, and shall give the notice provided for in said agreement and will pay or cause to be paid to

said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price, each year, on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2,240) pounds of iron ore so entitled to be taken for such year, and actually delivered by said Ore & Steel Company, it being understood that if any part of the quota for any year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof.'"

6. The said contract of December 16, 1914, between the stockholders of the Mahoning Ore & Steel Company, which was by reference made part of the said contract of March 11, 1916, contained among other provisions the following:

"The tonnage of each grade to be produced annually shall be fixed by the board of directors on or before April 1st, in each year, and notice of the fixing of said tonnage shall be mailed promptly to each stockholder.

"Each of the interests, as hereinbefore set forth, shall be entitled to take a full quota of each grade to be produced, in proportion to the amount of stock owned by or represented for them, and within fifteen days after receipt of notice referred to in preceding paragraph, shall notify in writing the president of said Mahoning Ore & Steel Company, whether or not it elects to take the full quota to which it is entitled. Undesired tonnage, if any, shall be offered pro rata to the other stockholders, and such portion thereof not desired by them can be disposed of by the board of directors by reducing the originally fixed production to the extent of the unaccepted tonnage or in any other manner the board of directors may agree upon.

"The price of ores shall be fixed each year by the board of directors and shall be at or about the cost of production, including all costs, transportation, delivery, handling, etc., to the lower lake ports."

7. The Cleveland Trust Company on January 31, 1918, transferred and assigned to William M. Andrews a 40/4000 interest in the then unpaid portion of the sale price of said stock and terminated the trust with respect thereto.

8. On October 29, 1916, Louisa Andrews assigned and transferred to John Shaw, by way of gift inter vivos, an interest of 80/4000 in the then unpaid portion of the sale price of said stock.

9. The value on March 1, 1913, of the shares of stock owned by the petitioners and sold by them under said contract of March 11, 1916, was in excess of the following sums, respectively:

Edith Andrews Logan	250	shares	$173,089.80
Henry W. Heedy	100	"	69,235.98
William J. Hitchcock	1,000	"	692,359.25

Frank Hitchcock	1,000	shares	$692,359.25
The Cleveland Trust Company, trustee for William M. Andrews	40	"	27,694.37
Julia Andrews Bruce	350	"	244,708.70

22 10. The value on October 29, 1916, of the 80/4000 interest in the unpaid portion of the sale price of said stock acquired by John Shaw by gift from Louisa Andrews on that date was in excess of $11,388.74.

11. Since the sale of said shares of stock under the contract of March 11, 1916, the petitioners have respectively received the following sums on account of the purchase price of said stock, down to and including the year 1920, the amounts shown for 1916 in each case representing the stockholder's share of $2,200,000 paid in cash under the contract of March 11, 1916:

Edith Andrews Logan—	
1916	$137,500.00
1917	9,900.00
1918	11,250.00
1919	8,995.50
1920	5,444.30
Henry W. Heedy—	
1916	55,000.00
1917	3,960.00
1918	4,500.00
1919	3,598.20
1920	2,177.73
William J. Hitchcock—	
1916	550,000.00
1917	39,600.00
1918	45,000.00
1919	35,982.00
1920	21,777.25
Frank Hitchcock—	
1916	550,000.00
1917	39,600.00
Frank Hitchcock—Con.	
1918	$45,000.00
1919	35,982.00
1920	21,777.25
23 William M. Andrews—	
1916	22,000.00
1917	1,584.00
1918	1,800.00
1919	1,439.28
1920	871.09
John Shaw—	
1917	3,168.00
1918	3,600.00
1919	2,878.56
1920	1,742.18
Julia Andrews Bruce—	
1916	192,500.00
1917	13,860.00
1918	15,750.00
1919	12,593.70

12. The total of the sums received by the several petitioners as the result of the sale of said stock owned by them and sold under the contract of March 11, 1916, down to and including the year 1920 was in each case less than the value on March 1, 1913, of the stock sold and less than the cost thereof; and in the case of John Shaw was less than the value of his interest at the date he acquired it by gift from Louisa Andrews.

13. On March 11, 1917, Louisa Andrews, Julia Andrews Bruce's mother, died, leaving a last will and testament which was duly admitted to probate and under which Julia Andrews Bruce received by request a 550/4000 interest in any payments that might subsequently become due under the said contract of March 11, 1916.

14. The value of the said 550/4000 interest so acquired by
24 Julia Andrews Bruce under her mother's will was fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax imposed upon the estate of Louisa Andrews at $277,164.50.

15. Since the death of her mother Louisa Andrews on March 22, 1917, Julia Andrews Bruce, down to and including the year 1920, has

received the following sums under said contract of March 11, 1916, on account of the 550/4000 interest in the future payments under said contract acquired by her under her mother's will:

1919	$19,790.10
1920	11,977.49

16. The total of the sums so received by Julia Andrews Bruce since her mother's death by virtue of the 550/4000 interest in the future payments under the contract of March 11, 1916, acquired by Julia Andrews Bruce under her mother's will was less than the value of the said 550/4000 interest as fixed by the commissioner for the purposes of the Federal estate tax upon the estate of Louisa Andrews, and less than the value of said interest at the date it was acquired by inheritance from her mother.

17. The several petitioners, between March 1, 1913, and December 31, 1920, kept no books and their returns for Federal income tax purposes for the years 1916 to 1920, inclusive, were made on the basis of cash receipts anad disbursements.

18. On March 11, 1916, the Mahoning Ore & Steel Company's property consisted of approximately 1,000 acres of leased mineral land and at that time between 400 and 500 acres were totally or practically unexplored.

19. Fifty per cent of the stock of the Mahoning Ore & Steel Company in 1916 was held by the Cambria Steel Company and the remainder by other steel companies.

20. Until 1909 or 1910 the policy of the Mahoning Ore & Steel Company had been one of conservation, the production running between 1,000,000 and 1,500,000 tons per annum.

21. In 1911, 1912, and 1913, owing to the increasing tax burden and the change of the control of the Cambria Steel Company, the company entered upon extensive stripping operations which placed it in a position to produce 3,000,000 tons a year.

22. Under the agreement of December 16, 1914, the amount of tonnage to be produced annually by the Mahoning mine was left to the determination of the board of directors of that company.

23. A difference of opinion existed between engineers and experts qualified by education and training in the iron-mining industry employed by the Mahoning Ore & Steel Company, on the one hand, and by the commissioner, on the other, as to the estimated annual production of the Mahoning mine and its life as of March 11, 1916.

24. Engineers employed by the commissioner estimated that at the date of the contract of March 11, 1916, the ore reserves of the Mahoning Ore & Steel Company were 82,858,535 tons; that the average annual future production from said mine would be 1,841,300 tons; and that the life of the mine was 45 years from March 11, 1916.

25. The estimate mentioned above and adopted by the commissioner as a basis for determining deficiencies in the income tax of the petitioners was based upon data furnished by the engineers of the Mahon-

ing Ore & Steel Company to the respondent to enable him to fix the depletion rate for the Mahoning Ore & Steel Company. It was based upon the content of recoverable ore in only approximately 620 acres out of the entire property leased by the company.

26. Since fixing the deficiency in the case of Edith Andrews Logan, the commissioner in a proceeding in which the depletion rate for the Mahoning Ore & Steel Company was changed, based upon data furnished by the company and the opinions of duly qualified engineers and experts employed by him, found that the life of said mine was 40 years from March 1, 1913, and that the estimated ore reserves of said mine on March 1, 1913, were 88,561,533 tons. The tonnage mined from the Mahoning mine from March 1, 1913, to March 11, 1916, was 5,039,655 tons.

27. The actual ore in tons mined annually for the Mahoning Ore & Steel Company between 1913 and 1926, inclusive, was as follows:

1913	1,515,428	1920	1,720,537
1914	1,212,287	1921	303,020
1915	2,311,940	1922	1,011,204
1916	2,215,788	1923	3,029,865
1917	2,525,144	1924	1,717,092
1918	2,019,481	1925	1,699,133
1919	1,217,167	1926	1,813,811

28. Assuming that the said Mahoning mine had ore reserves on March 11, 1916, of 82,858,535 tons, and further assuming that all said ore would be mined, and 12 per cent thereof, namely, 9,942,664.2 tons, would be delivered to Youngstown Sheet & Tube Company, the total amount which would be received under the provisions of the contract of March 11, 1916, by all the vendors of said stock and their successors in interest would be the sum of $5,965,814.52, at the rate of 60 cents per ton.

29. The present worth of the sum of $5,965,814.52, based upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6 per cent, with provision for a sinking fund at 4 per cent, was on March 11, 1916, $1,942,111.46, which is the value of the contract at March 11, 1916, determined by the commissioner and used by him in computing deficiencies in tax.

28. OPINION

SMITH: In the petition of Edith Andrews Logan it is stated that "the tax in controversy is income tax for the years 1915 to 1920, inclusive, and is more than $10,000, to wit, $22,048.63." The notice of deficiency attached to the petition shows overassessments for the years 1915, 1916, and 1917, covered by claims filed in the aggregate amount of $1,951.48, and deficiencies in tax for the years 1918, 1919, and 1920 in the aggregate amount of $22,048.63. The pleadings do not present basic facts showing that the board has any jurisdiction to determine the correct tax liabilities for the years 1915, 1916, and 1917, and the petitioner in her brief makes no reference to those

years. The appeal is accordingly dismissed in so far as it relates to the years 1915, 1916, and 1917.

The remaining issues presented by these proceedings are the same as those presented in Julia Andrews Bruce et al., 5 B. T. A. 300, wherein we held that the transaction which took place in 1916 was a completed sale and that the amounts of money received by the petitioners during the tax years under the contract of March 11, 1916, were in part a return of capital and in part taxable income. It was argued before the board in those proceedings, as it is argued by counsel for the present petitioners, that the interest of the petitioners in the contract of March 11, 1916, had no fair market value in 1916 and that, therefore, the transaction was not a closed one and
29 that the petitioners were not liable to income tax upon moneys received in future years under the contract until they had recovered back the cost of fair market value on March 1, 1913, whichever was higher. In the opinion we stated:

"The petitioners have also raised the point that there was no market value for the contract right received by Julia Andrews Bruce and Louisa Andrews in 1916. The only testimony offered in support of these contentions was by Hitchcock, former president of the Andrews & Hitchcock Iron Company. This witness testified that in the negotiations for the sale of the stock there was no discussion concerning a full cash payment, because the buyer, the Youngstown Sheet & Tube Company, could not afford to pay cash in full. This is all the testimony offered in support of the allegation that the contract to receive future payments had no market value."

The present petitioners contend that unlike the Julia Andrews Bruce case, supra, they have offered affirmative proof showing that the contract of March 11, 1916, under which their shares of stock were sold, in so far as the future indeterminate payments were concerned, had no fair market value.

Frank Hitchcock, the president of the Andrews & Hitchcock Iron Company, on March 11, 1916, testified at the hearing of the present cases:

"Q. Mr. Hitchcock, at that time, namely, March 11, 1916,
30 did you know of any market where you could have obtained, or did you know of any market where could be sold, an interest of 12% of the stock of the Mahoning Ore & Steel Company?—A. No; not at its value.

"Q. Mr. Hitchcock, in 1916 was there any price established by public sale or sales in the way of ordinary business, of similar contracts to this contract of March 11, 1916, by which the fair market value of the contract at that time, at the time it was made, could be determined?—A. No.

"Q. Was there in 1916 any general market for contracts of this character, and any established or current market price?—A. No."

John B. Putnam, connected with Pickands, Mather & Company, Cleveland, Ohio, likewise testified that in his opinion there was no

fair market for the interests of the several petitioners in the contract of March 11, 1916; that the vendors on any sale of this contract in 1916 could not have readily realized in cash or its equivalent its real value.

J. C. Agnew, mining engineer, was connected with the Mahoning Ore & Steel Company from 1904 to 1923, testified:

"Q. In 1916, was there any price established by public sales or sales in the way of ordinary business, of similar contracts, by which the fair market value of that contract at the time it was made could be determined?—A. No.

31 "Q. Was there in 1916 any general market for contracts of that character and any published or current market price for the same?—A. Not to my knowledge.

"Q. In your opinion, could the vendors or sellers under that contract, or any sale of the contract, have realized in 1916 in cash or its equivalent its real value?—A. No; I do not think so."

Of the above witnesses, Hitchcock and Agnew testified before the board in Julia Andrews Bruce et al., supra. The only additional witness for the petitioners in the present proceedings is John B. Putnam. He did not profess to be an expert on any subject connected with mining and did not claim to have anything more than general information as to any subject connected with these proceedings. He stated that he was generally familiar with iron-ore contracts. He also stated:

"There have been sales of iron-ore mines, but I am not familiar with any except in a general way."

Two mining engineers testified for the respondent that in their opinion it was practicable and feasible to estimate both the reserve and probable life of the Mahoning mine. Both of these men were familiar with the property in controversy. One of the engineers had taken part in formulating the commissioner's determination as to the probable life of and as to the tonnage of ore in the mine.

32 He stated that the pit operated by the Mahoning Company adjoined another pit known as the Hall Rust Mine on adjoining property and that the two properties constituted one mine from a physical standpoint, and that it was the largest developed iron mine in the United States. The iron is found in a well-defined formation and is one of the best grades of iron ore in the United States. Above the iron ore is the surface or overburden of glacial drift, varying from 5 to 30 feet in thickness. He stated:

"The physical conditions make it feasible to estimate the ore content. You can make a very accurate estimate of it. I would say the degree of accuracy obtained in estimating ore reserves in this property will be much higher than at any other mine that I know of because of the geographical conditions and the development of the work, the drill work, and the activity of adjacent properties * * *. I do not know of any mining section where it is as easy to make an estimate of ore reserve as it is on the Mesaba."

The stipulation filed in these proceedings shows that the respondent estimated ore reserves and probable life as of 1916 and also as of 1913. The estimate of reserve in 1913 when modified by the ore mined between 1913 and 1916 is within one-half of one per cent of the 1916 estimate. In 1913 the probable life was estimated at 40 years and in 1916 at 45 years. On this point one of the engineers for the respondent testified:

33 "The commissioner's appraisals of 40 years as of March 1, 1913, and 45 years as on March 11, 1916, are very consistent, because they were made as of different basic dates. In each case you had a different set of facts on which to base the valuation. In the later appraisal you had additional history of three years to consider. The production for those three years was slightly less than 2,000,000 tons a year, and during those three years the demand for iron ore was about the average."

All of the mining engineers who testified before the board agreed that the production of a mine of the character of the Mahoning mine here involved is strongly influenced by the general conditions of business in the country. They were agreed that in times of prosperity the production will be greater than in times of depression. J. C. Agnew, testifying for the petitioners, stated:

"The demand for iron ore bears a very close relation to the general prosperity of the country * * *.

"In estimating the future production of the Mahoning mine as of 1916 the general demand in this country for iron ore would certainly be an important factor. Another important factor would be the condition of the industry in this country, whether times were prosperous or otherwise."

The two Government engineers concurred in this view.

34 Upon the basis of data furnished by the Mahoning Ore & Steel Co., the respondent determined that the ore in place as of March 11, 1916, was 82,858,535 tons. It is in evidence that this estimate did not take into consideration ore, if there was any, in approximately 400 acres of land controlled by the company. No evidence has been adduced before the board that would prove the inaccuracy of the estimate. The doubt, if any exists, is as to the length of time it will take to mine the ore. Upon the basis of data furnished by the Mahoning Co. the respondent estimated that the life of the mine would be 45 years from March 11, 1916, and that the average annual production would be 1,841,300 tons. During the eleven-year period from 1916 to 1926, inclusive, the total production was 19,272,242 tons, or an average annual production of 1,752,000 tons.

The contract which the stockholders of the Andrews & Hitchcock Iron Co. had with the Youngstown Sheet & Tube Co. was that they should receive 60 cents per ton upon their 12 per cent. interest in the ore mined from the Mahoning mine. The important question in the case is as to whether that contract had a fair market value as of

March 11, 1916. The petitioners contend that they could not have gotten a fair market value for their interests in the contract if they had attempted to sell them. Witnesses for the petitioners believed that the true value of the interest of each of the petitioners was much in excess of what each could have sold it for. This question of belief does not, however, in our opinion, satisfactorily establish that the interests had no fair market value. In 1916 it could be
35 foreseen that each of the petitioners would receive considerable amounts of money under the contract during the years immediately succeeding 1916. It is hardly probable that persons conversant with the contract would not have given something for the interests of the several petitioners therein. Statements that the contract had no value because in the opinion of certain witnesses the interests of petitioners therein could not have been sold at their full market value is not satisfactory evidence that they did not have a fair market value.

In support of their contention that the contract of March 11, 1916, had no fair market value in 1916 the petitioners cite the decision of the court in Bourne v. McLaughlin, 19 Fed. (2d) 148. We are of the opinion that that case is readily distinguishable from the cases at bar and is not controlling here. In that case the court expressly stated that the stock could not have been disposed of "except at such a sacrifice as to amount to a virtual donation," and that attempts to sell the stock were unsuccessful. There is no such evidence before the board in the proceedings at bar.

Upon the record made we are of the opinion that the contract received by the petitioners as a part consideration for their holdings in the Andrews & Hitchcock Iron Co. had a determinable fair market value when received by them in 1916. No evidence has been adduced that the determination of the commissioner of the fair market value of the interests of the several petitioners at the basic dates
36 were in error, and in the absence of such evidence the determinations of the respondent of such values are approved.

The petitioners' contention that they derived no taxable income from payments made to them during the taxable years because up to the close of 1920 no one of them had received under the contract the admitted value of the property sold either as of March 1, 1913, or March 11, 1916, is very similar to that which was made before the board in Ruth Iron Co. et al., 4 B. T. A. 1151, wherein it appeared than in January, 1913, the petitioners sold certain ore-bearing property and each of them received in exchange for its or his interest therein a certain amount in cash and 41 noninterest-bearing promissory notes, payable annually thereafter, endorsed by the United States Steel Corporation and further secured by a vendor's lien upon the property. Upon the facts presented we held that the amounts received by the petitioners upon the payment of their respective notes in the years 1919, 1920, 1921, and 1922 in excess of the fair market value of such notes on March 1, 1913, which value was in

excess of cost, was taxable income. One of the petitioners in that case was Francis S. Kosmerl and from the adverse decision of the board appealed the case to the Circuit Court of Appeals for the Seventh Circuit. In an opinion handed down February 18, 1928, the order of the board was affirmed. In the course of the opinion the court stated:

"For petitioner a witness testified generally that at the time the notes were given the ore body was worth more than 35
37 cents per ton. But the ore at that time was plainly not worth that much to the owners, who had optioned it under the lease at 35 cents a ton, not payable in cash, but as and when it should be mined, over a period which, on January 1, 1913, had yet 41 years to run; so that while the lessee had the right to exhaust the property at 35 cents per ton, this might not, and probably would not, have been payable until many years after the date when the lease was abandoned and the sale consummated. So it appears that the actual consideration which passed from the owners was not a present 35 cents per ton, but that price over a period up to 41 years thereafter, thus greatly reducing the 35 cents per ton value of the consideration which passed in payment for the notes.

"And so with respect to the notes themselves, which, by their terms, matured up to 40 years from their date, without interest. That the notes were good is quite beyond dispute—good, however, only for their face value at maturity, but surely not good for their face value when made. That a note, however absolutely good the security, due 40 years from its date, without interest, is not worth its face at time of making is apparent from the mere statement; and so with the notes in question, paid in 1921 and 1922, eight and nine years from their date. Conceding these notes to have been capital assets of the taxpayer on their date, they were capital assets not for their face value but for the materially less amount
38 which the notes were then actually worth; and in their payment at maturity there was plainly gain, profit, or income to the extent of the difference.

"In Platt v. Bowers, 18 F. (2nd) 951, the court dealt with a very similar situation, and held that while the annually maturing obligations represented capital assets, and were not taxable as gains, profits, or income, yet where the obligations were for serial annual payments without interest, under the acts of 1918 and 1921 there was, upon conversion of the obligations through their payment, profit to the extent of the difference between the value of the obligations on March 1, 1913, and the amount so realized thereon."

The above-referred-to case is not an exact parallel to the cases at bar, for there the petitioners parted with a note during each taxable year and received the face value thereof. Here the petitioners parted with shares of stock in Andrews & Hitchcock Iron Company in 1916 for a cash consideration and a contract entitling them to receive an amount per annum to the end of the lease held

by the Mahoning Ore & Steel Co. based upon the amount of ore mined during each year. The number of tons of ore in the mine was susceptible of accurate determination and the amount of the ore to be mined annually over a period of years was likewise susceptible of determination. If the difference between the present worth
39 of the noninterest-bearing notes in 1913 in the Kosmerl appeal and the amount received during the taxable year was income of the taxable year, we think that the application of the same principle to the proceedings at bar requires the petitioners to return as taxable income a portion of the amount of royalties received each year. This was substantially the decision of the Circuit Court of Appeals, Third Circuit, in Kate W. Rosenberger v. McCaughn, March 3, 1928 (not yet reported). The plaintiff in suing to recover the tax paid on amounts received under a mining lease entered into prior to March 1, 1913, claimed that inasmuch as under the Pennsylvania law the lease was treated as a sale of coal in place the payments received should be treated as a return of capital. In the course of the opinion the court stated:

"Reverting to the plaintiff's contention that all payments she had received under the instrument here in question were tax free because they were part payments of the purchase price of property sold prior to March 1, 1913, still—always keeping in view the nature of mining, the source of the proceeds—we think each payment represented in some measure both capital and increment, capital because it stood in the place of coal and increment because in the payments running through ninety-nine years interest on the capital must inevitably have been included, and that this increment or interest was a gain 'derived' within the generalization of the statute 'from any
40 source whatever' and was income in substantially the sense of New Creek Coal Company v. Lederer, 295 Fed. 433 (4 Am. Fed. Tax Rep. 3769). The plaintiff can very properly demand that the capital included in her proceeds from mining shall not be taxed. United States v. Ludey, 274 U. S. 295 (6 Am. Fed. Tax Rep. 6754); New Creek Coal Company v. Lederer, supra. But when the capital in the proceeds has been determined and set aside the balance is income and is the very thing on which the Government lays its hands and exacts a tax. Stratton's Independence v. Howbert, 231 U. S. 399 (3 Am. Fed. Tax Rep. 2883); * * *. See also Florence L. Klein, 6 B. T. A. 617."

At the hearing of these proceedings counsel for the petitioners stated that they desired merely to submit to the board these cases on the sole and particular question whether the 1916 transaction was a closed transaction and that if upon the evidence submitted the board was of the opinion that it was a closed transaction then the deficiencies must be redetermined in accordance with the board's decision in Julia Andrews Bruce et al., supra, in which the same contract was involved. Counsel for the respondent objected, however, to the redetermination of the deficiencies in accordance with the Julia

Andrews Bruce et al., supra, decision and contended that the deficiencies should be redetermined to be the amounts found by the respondent.

In Julia Andrews Bruce et al., supra, we held:

"* * * The commissioner in his determination of the
41 deficiency has determined the fair market value of the right to receive future payments, and from the evidence presented we can not say that his determination is not correct. A portion of each payment under the contract was a return of capital and a portion represented gain. The commissioner has determined what portion is gain by dividing the 1916 value of the contract by the total tonnage to be obtained, reaching the conclusion that the payment for each ton represents 19.53 cents return of principal and 40.47 cents income, or, in other words, that each payment, whether made one year after the agreement was made or 45 years thereafter, is made up 35.554 per cent return of principal and 67.446 per cent income.

"The payments to all the stockholders were estimated by the commissioner to be $132,573.60 annually for 45 years. These payments were reduced to present worth, using a discount of 6 per cent on future payments with a 4 per cent return on sinking fund. It is evident that the present worth of the payment to be received at the end of the first year differs substantially from the present worth of the payment to be received 45 years in the future. It is further evident that the present worth of all of the payments is the sum of the present worth of each annual payment, proper adjustment for the sinking fund being made. In determining what portion of the payment represented a return of the 1916 value, the commis-
42 sioner has made the allocation between principal and gain as if the present value in 1916 of each of the annual payments to be received was exactly the same * * *."

Our question now is whether we were correct in reaching the above conclusion. It will be noted from the foregoing that for the purpose of determining the amount of income received by each petitioner from the royalty payments, the commissioner considered that of each royalty payment received a part represented a return of the value of the contract on April 11, 1916, and the balance represented income. The amount of each royalty payment which represented a return of capital was determined by dividing the fair market value of the contract on April 11, 1916, by the estimated tons of ore in the mine on that date. The difference between the royalty payment of 60 cents and the foregoing amount was taken as the income received on account of each ton of ore mined. The income for a given year was obtained by multiplying the unit of income for a single ton of ore by the total number of tons mined in a given year. The board rejected the respondent's basis and held that—

"The proper manner in which to determine what portion of the payment is principal is to split up the total 1916 present worth into its component parts and to treat the present value of the first year's

payment as a return of principal upon the first 1,841,300 tons (the estimated annual production) mined, the present value of the
43 second year's payment as a return of principal upon the second 1,841.300 tons mined, and similarly each year until the mine becomes exhausted, or the principal is all returned."

In this manner the greater part of the amounts received in the first years would represent a return of principal and a small part income, whereas during the last years of the existence of the contract the reverse situation would be true regardless of the income produced by the contract in the various years. For example, under this theory, the amount to be accounted for each year would be $1,064,600, and in the first year approximately 94 per cent would be considered a return of principal, and approximately 6 per cent income, whereas in the forty-fifth year approximately 6 per cent would represent a return of principal and approximately 94 per cent would represent income.

Does the foregoing decision of the board afford a reasonable basis for the determination of the amount of income of the petitioners from the royalty payments received? It is believed that this question may best be answered by keeping in mind the nature of the asset received when the 1916 transaction was effected. What happened in 1916 was that certain stock was sold for $2,200,000 and a contract which the respondent determined had a fair market value at date of receipt of $1,942,111.46, which value we have approved for lack of evidence showing error on the part of the respondent in making such determination. The contract in question was an income-producing asset in that under its terms the owners
44 thereof were entitled to receive income to the extent of 60 cents a ton on a certain part of the ore that was to be mined and the contract was exhaustible in that it had a value only so long as there remained ore to be mined.

The board is of the opinion that a proper solution to the question of what part of the royalties received constituted taxable income lies in considering the entire amount of royalties received in a given year as includable in gross income and then in permitting a reasonable deduction therefrom in each year for the exhaustion of the contract. Section 213 (a), revenue act of 1918, provides in part that gross income—

"Includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer * * *."

We can not escape the conclusion that the foregoing provision would require all royalties received to be included in the gross income of the recipient. But all of the amounts received
45 would not be subject to tax for the reason that in the production of this income the asset which produced this income was gradually being exhausted and Congress provided in section 214 (a) (8), revenue act of 1918, that there shall be allowed as a deduction from gross income "A reasonable allowance for the exhaustion * * * of property * * *." No one would seriously question that a contract is property, and we think it equally clear that the contract in question is property which is being exhausted in the production of income and, consequently, that a deduction on account thereof is justified under the foregoing provision of the statute. See Lynch v. Alworth-Stephens Co., 267 U. S. 364. The difference between the royalties received and the allowance for exhaustion would constitute gain derived from capital which would satisfy the classic definition of income as laid down in Stratton's Independence v. Howbert, 231 U. S. 399, and since often reiterated, to the effect that income is the "gain derived from capital, from labor, or from both combined." Here the gain derived from capital, which capital is in the form of a contract which was received in part payment for stock which was sold and which will be productive of income until exhausted.

Our next question is what constitutes a reasonable allowance for the exhaustion of the contract. Since the value attaching to the contract is an account of royalties to be received as the ore is mined, we are of the opinion that a reasonable allowance in each year is determinable upon the basis of the ore mined. It is true that we are not here seeking to determine depletion in the case of a mine, yet
46 the relationship between the exhaustion of the mine and the exhaustion of the contract are such that we think the same principles would be applicable in each case. The method for computing the deduction for the depletion of mineral deposits, as set out by the commissioner in his regulations, is on the basis of the annual production. Article 210 (b), Regulations 45, provides:

"When the value of the property at the basic date has been determined, depletion for the taxable year shall be determined by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold within the taxable year. * * *"

See also articles 201, 202, 203, and 204 of the same regulations. In New Creek Co. v. Lederer (C. C. A.), 295 Fed. 433, the court had before it the question of the reasonableness of the commissioner's regulations with respect to depletion under the revenue act of 1916, which embody the same principle which appears in the aforementioned regulations (in so far as material to this discussion), the Government there contending that—

"Royalties represented both capital and income and that the allowance for capital depletion which the statute authorized was to be determined by the value in the ground of each ton of coal on
47 March 1, 1913, * * * * multiplied by the number of tons mined in the year for which the tax was payable."

In approving the commissioner's regulations as providing a reasonable depletion allowance the court said:

"* * * On the theory of the statute, as we read it, depletion allowance was intended as a return to the taxpayer of the original cost of the coal so that he may be taxed not on the whole of its sale price in the event that he is an operating owner, or on the full amount of royalties if he is a lessor, but that he may be taxed on the difference between the cost (capital) and the sale price or royalties received (income). (Of course, in estimating income on sale price other factors enter.) If he were allowed to deduct in each year the full amount of the sale price or the full amount of the royalties received (as the plaintiff here claims), the practical effect would be that he would, for many years, pay no tax at all, and this regardless of the fact that the total sale price (or total royalties) may, ton by ton, show a profit over the original capital cost. It is this profit or net income annually earned which the act taxed annually. And in this regard we see no distinction in the application of the principle to a mine owner whose income is royalties and to a mine owner whose income is derived from working the mines and selling the coal. The only difference is that in the latter more
48 factors enter into the calculation. The principle is the same.

"We do not find that the rules and regulations prescribed by the Secretary of the Treasury for the enforcement of the allowance for depletion under the provisions of the revenue act of 1916 are, in view of the subject matter of taxation, unreasonable, or that by these rules the taxable was deprived of the deduction which the statute allowed."

Likewise, in Lynch v. Alworth-Stephens Co., supra, where it was held that a lessee of a mine is entitled to an allowance for depletion, the court said:

"It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and, since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent does not own the ore deposits, its right to mine and remove the ore and reduce it to possession and ownership is property within the meaning of the general provision. Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same
49 mines is likewise lessened. There is an exhaustion of property in the one case as in the other; and the extent of it, with the

consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered."

The board is convinced that the foregoing principles which were considered applicable in determining a reasonable allowance for the depletion of a mine would apply with equal force in determining the reasonable allowance for the exhaustion of a contract which is dependent for its value upon the right to receive a royalty upon the content of a mine as the ore is mined and which value will be reduced or exhausted as the ore is taken from the ground.

While in the instant case the respondent divided the royalties received as between a return of capital and income, the result reached is the same as if the entire royalties received had been included in gross income and an allowance for exhaustion of the contract treated as a deduction from this gross income. In fact, the end sought in an exhaustion allowance is to have the capital sum invested in a wasting asset returned to the taxpayer as a charge against income earned by the asset and in this way avoid taxing a return of capital. The entire income earned is not taxable, but only so much thereof as does not represent a return of capital. The return
50 of capital is represented in the case at bar by the exhaustion allowance, which, when deducted from the total royalties received, will produce the same amount of taxable income as determined by the respondent. See the Royal Collieries Company, 1 B. T. A. 369. The action of the respondent is accordingly sustained.

In the instant proceedings we are not attempting to lay down a rule for the determination of a reasonable amount for depletion in the case of a mine. Nor do we attempt to determine what would be a reasonable allowance for the exhaustion of a contract where the facts are substantially different from those which obtain in the instant proceedings. All that we do determine is that the method invoked by the respondent of computing the income from the contract is reasonable and should be sustained in the absence of evidence of error on the part of the respondent in making such determination.

The foregoing principles, as to the manner in which income from the contract shall be reported are, of course, inconsistent with the method approved by the board in Julia Andrews Bruce et al., supra, in that under the Bruce case neither the income to be reported nor the allowance for exhaustion bear any necessary relation to the income received in a given year, nor to the extent in which exhaustion has been suffered in the production of this income. It is true that in the valuation of this contract we have based our conclusion as to the fair market value upon the basis of the present worth of the royalties which it was estimated would be received over the
51 life of the contract, but because we followed this method of valuation does not mean that where, for example, the same

tonnage of ore was mined in the first year and in the last year of the existence of the contract the greater part of the royalties in one case would be capital and in the other case income. The net income in each case would be the same. The value which we arrived at was such a value as we considered would have resulted had the contract been offered for sale by a person willing to sell and had been acquired by a person willing to buy. In effect, the method followed and the result reached is not essentially different from that in the case of the valuation of a leasehold at March 1, 1913. In such case a value is often assigned to the leasehold for the reason that had it been necessary to renew the lease on that date the rental to be paid would have been greater than was being paid under the terms of the lease negotiated prior to March 1, 1913, and, consequently, we say that there will be a saving over the remaining life of the lease of the difference between the two rental amounts, which reflects a March 1, 1913, value of the leasehold. Even though such value may be arrived at on the basis of the present worth of the savings over the period of years, we have never heard it contended that the deduction allowable in a given year on account of the exhaustion of such a leasehold value should bear any relation to the present worth value of the saving for such year. The basis for exhaustion of such a leasehold which has been recognized repeatedly by the board and the courts is either a time or production basis depending upon
52 the nature of the asset, and that regardless of the fact that in determining the March 1, 1913, value the value of the saving for the first year would be greater than for any succeeding year. We do not conceive that the situation with respect to the exhaustion of the contract in question would have been different had the valuation which we arrived at been upon the basis of an offer to buy the contract rather than the present worth method. An offer to buy would necessarily have been predicated upon the profits to be realized from the contract and the profits which were expected to be realized one year hence would have been a greater present value than the profits which were expected to be realized forty-five years from that time, yet had the valuation been fixed on such an offer it is hardly to be supposed that it would be seriously contended that the income to be reported and the exhaustion to be allowed would bear any relationship to such values. To the extent, therefore, that the opinion in Julia Andrews Bruce et al., supra, is in conflict with the views hereinbefore expressed the same is overruled.

Reviewed by the board.

Judgments will be entered for the respondent.

Dissenting opinion

PHILLIPS, dissenting in part: The difficulty I encounter in the present case is in reconciling the method by which the capital value of the contract is determined with the method by which the capital

53 returned by each payment is computed. In valuing the contract a method is used which recognizes that payments to be received in the future must be discounted to their present value. (Findings 28 and 29.) Upon this basis it is recognized that the right to receive royalties from the ores to be mined in the first year of operations is much more valuable than the right to receive royalty from an equal number of tons of ores to be mined several years later. The value of the contract is determined to be the sum of the present value of these future payments. (Findings 29.) In this manner the value of a contract is determined by assigning a capital value to the royalty upon each ton of ore to be mined in the future, a greater capital value per ton being assigned to the royalty from the first ore mined than to the royalty from the ore which is mined later. It seems to me that if we are to use this method of determining the capital value of the contract we are not justified in departing from it when the royalties are received and we are called upon to determine what portion of the amount received from each ton mined represents capital value.

The rule adopted by the commissioner and followed by the board by which a uniform value is assigned to the royalty right in each ton of ore, whether mined in the first year or the last year of operations, may be proper in a large majority of cases, but it seems to me that it cannot properly be applied where, as here, in determining the capital value of the contract capital values have been assigned to the right to receive royalties on these ores which vary according to the
54 time when the ores will be mined. It is my opinion that in such a case the petitioners have received income only to the extent that the royalties received in the taxable years exceed what has been determined to be the present value at the time the contract was made of the right to receive the royalties on an equal number of tons of ore. The computation of income upon this basis is no more difficult than the computation of the present worth of the right to receive royalties; it requires, in fact, nothing more than the use of the same tables used in the computation of value.

This principle has received the sanction of the courts in Hull v. McHale (United States District Court for the Eastern Division of the Northern District of Illinois) not reported, which was affirmed by the Circuit Court of Appeals for the Seventh Circuit in McHale v. Hull, 16 Fed. (2nd) 781, and followed in Spalding v. Reinicke, not reported, which arose in the same district.

TRAMMEL agrees with this dissent.

Now, October 3, 1929, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

55 Before United States Board of Tax Appeals, Washington

Docket No. 18202

JULIA ANDREWS BRUCE, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order of redetermination

Pursuant to the board's findings of fact and opinion, promulgated June 14, 1928, it is

Ordered and decided that, upon redetermination, there are deficiencies for the years 1918 and 1919 in the amounts of $9,419.61 and $11,285.51, respectively.

(Signed) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

Entered June 15, 1928, Washington, D. C.

Enter:

Now, October 3, 1929, the foregoing order of redetermination certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

56 Before United States Board of Tax Appeals

[Title omitted.]

Petition for review

TO THE HONORABLE THE JUDGES OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT:

Your petitioner, Julia Andrews Bruce, respectfully shows:

I. JURISDICTION FOR REVIEW

This is a proceeding pursuant to the provisions of section 1001 of the revenue act of 1926, as amended, for review by the United States Circuit Court of Appeals for the Second Circuit of a decision of the United States Board of Tax Appeals entered on the 15th day of June, 1928, redetermining deficiencies in income tax against your petitioner for the calendar years 1918 and 1919 in the amount of $9,419.61 and $11,285.51, respectively.

Your petitioner at the present time is a citizen of the United States and is an inhabitant of the town of Greenwich in the State of Connecticut.

57 II. NATURE OF CONTROVERSY

The controversy before the United States Board of Tax Appeals concerned the propriety of the action of the Commissioner of Internal Revenue in treating as taxable income for the years in question any portion of the sums received by petitioner during those years as part of the sale price of shares of stock in the Andrews & Hitchcock Iron Company, which were sold during the year 1916 under the following circumstances:

Prior to March 1, 1913, and continuously to March 11, 1916, petitioner owned 350 shares and her mother, Louisa Andrews, owned 1,100 shares of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which at all times mentioned had 4,000 shares of capital stock issued and outstanding. Said Andrews & Hitchcock Iron Company at all times between March 1, 1913, and March 11, 1916, owned among other assets twelve per centum (12%) of the capital stock of the Mahoning Ore & Steel Company, a Pennsylvania corporation, which held under lease dated April 1, 1895, and running for 97 years after said date, certain mineral lands in the Mesaba Range of Minnesota.

Under a certain contract of December 16, 1914, between the stockholders of said Mahoning Ore & Steel Company, including said Andrews & Hitchcock Iron Company, said stockholders agreed in substance (1) that the board of directors should fix on or before April 1, of each year, the annual tonnage of iron ore to be pro-
58 duced; (2) that each stockholder should be entitled to take a full quota of each grade of iron ore to be produced annually in proportion to the amount of stock owned by him; (3) that the price of said ore should be fixed each year by the board of directors at or about the cost of producing, including all costs, transportation, delivery etc., to the lower lake ports.

On March 11, 1916, all of the stockholders of said Andrews & Hitchcock Iron Company, including petitioner, and her mother, Louisa Andrews, entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, to sell to said corporation all of the shares of capital stock held by them in said Andrews & Hitchcock Iron Company. The contract of March 11, 1916, incorporated by reference the provisions of the contract of December 16, 1914, above mentioned. In consideration for said sale, said Youngstown Sheet & Tube Company paid for the benefit of the stockholders of said Andrews & Hitchcock Iron Company $2,200,000 in cash on or before April 11, 1916, and further, by way of additional consideration for said sale and as the balance of said purchase price covenanted and agreed to pay to the Dollar Savings & Trust Company of Youngstown, Ohio, for the benefit of said stockholders of the Andrews & Hitchcock Iron Company each year, on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) for each and every

ton of 2,240 pounds of iron ore which it might be entitled to take from the Mahoning Ore & Steel Company and actually delivered by said company.

59 Louisa Andrews, the mother of the petitioner, died on March 22, 1917, leaving a last will and testament under which the petitioner acquired by bequest a 550/4000ths interest in any payments that might subsequently become due under the contract of March 11, 1916. This interest was valued by the Commissioner of Internal Revenue for purposes of the Federal estate tax imposed on the estate of Louisa Andrews at $277,164.50.

The value on March 1, 1913, of the 350 shares of stock of the Andrews & Hitchcock Iron Company owned by petitioner and sold by her by said contract of March 11, 1916, was greater than cost, and was also greatly in excess of $234,703.70, which is the aggregate amount received by petitioner over the period down to and including the year 1919 in respect of the purchase price of said 350 shares of stock, as follows:

1916	$192,500.00	(Petitioner's share of $2,200,000 paid in cash under contract of March 11, 1916.)
1917	13,860.00	
1918	15,750.00	
1919	12,593.70	
Total	$234,703.70	

Petitioner, prior to and including the year 1919, received the following sum under said contract on account of the 550/4000ths
60 interest in the future payments under said contract acquired by her by bequest:

1919	$19,790.10

The sum so received by petitioner since her mother's death was less than the value of the said 550/4000ths interest as fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax upon the estate of Louisa Andrews and less than the value of said interest at the date of acquisition by petitioner.

The petitioner, between March 1, 1913, and December 31, 1919, kept no books, and made her returns for Federal income tax purposes for the years 1916 to 1919, inclusive, upon the basis of cash receipts and disbursements.

In her income tax returns for the years 1918 and 1919 the petitioner did not report as income any portion of the amounts received by her during those years under the contract of sale of March 11, 1916. She contends that the future purchase price to be paid by the Youngstown Sheet & Tube Company under said contract (hereinafter referred to as "the obligation of the Youngstown Company") had, as a matter of fact, at the date of the sale no fair market value and was, in any event, not the equivalent of cash; that there was, therefore, as a matter of law, no sufficient basis for the determination of gain or loss upon the sale in 1916 in the case of a return made upon the basis

of cash receipts; and that she is entitled to treat all receipts from the sale of stock (including her share of the $2,200,000.00 paid by the Youngstown Company in 1916) as a return of capital until she
61 has recovered the cost or other statutory basis of the property disposed of. The petitioner further contends that even if the obligation of the Youngstown Company had, as a matter of fact, a fair market value or a determinable equivalent in cash at March 11, 1916, the Commissioner of Internal Revenue did not correctly determine that value or equivalent or, as a matter of law, correctly allocate as between income and the return of such value or equivalent (whatever its amount) the cash payment received by the petitioner during the years under review in liquidation of said obligation.

The Commissioner of Internal Revenue (1) treated the obligation of the Youngstown Company as having a fair market value at March 11, 1916, and (2) purported to determine that value at $1,942,111.46. He further determined not only (3) that the petitioner was not entitled to the return of her capital or statutory base prior to the realization of income, but also (4) that (irrespective of the time when it was or might be expected to be received) a fixed proportion of each dollar received by petitioner from said Youngstown Company represented return of capital, to wit, 32.554 per cent, and the remainder a realization of income, to wit, 67.446 per cent. (These percentages varied slightly in the case of payments received on account of the interest acquired by the petitioner under the will of her mother.) Accordingly, he determined that petitioner realized income from the payments during the years in question as follows:

1918	$10,623.38
1919	21,733.85

62 These were the final determinations, and he proposed the additional taxes now in controversy against petitioner in consequence of such determinations.

Upon appeal to the United States Board of Tax Appeals, the final administrative agency in the executive branch of the Government, said board affirmed the action of the Commissioner of Internal Revenue in all particulars.

The sole question here is whether the action of the board was proper under the law and upon the evidence.

III. ASSIGNMENT OF ERRORS

In affirming the action of the Commissioner of Internal Revenue and in purporting to find and determine a fair market value in 1916 for the obligation of the Youngstown Company, and in determining that a certain proportion, to wit, 32.554 per cent, of each payment received by petitioner represented a return of capital and the remainder, to wit, 67.446 per cent, represented taxable income, the United States Board of Tax Appeals committed the following errors, upon which petitioner relies as the basis of this proceeding:

ERRORS OF FAILING TO MAKE FINDINGS OF FACTS REQUESTED

(1) Said board erred in that it failed to find that the obligation of the Youngstown Company to make future payments under said contract of March 11, 1916, had no fair market value at
63 the time said contract was made, though requested so to find, and though the fact was material and fully established by evidence. (Petitioner's proposed Finding No. 19.)

(2) Said board erred in that it failed to find that said obligation of the Youngstown Company was not substantially the equivalent of cash and/or was not readily convertible into cash in the year 1916, though requested so to find and though such facts were material and fully established by evidence. (Petitioner's proposed Finding No. 20.)

(3) Said board erred in that it failed to find that in 1916 there was no price established by public sales or sales in the way of ordinary business of contracts reasonably similar to the contract of March 11, 1916, by which the fair market value of the obligation of the Youngstown Company at the time and place indicated could be determined; and that, in 1916, there was no general market for obligations of the character here involved and no established or current price for such obligations. The board was requested so to find and failed to do so, though such facts were material and fully established by evidence. (Petitioner's proposed Finding No. 21.)

(4) Said board erred in that it failed to find that in 1916 the vendors under the contract of March 11, 1916, on any sale or transfer of their interests thereunder could not have realized in cash or
64 its equivalent the real value or substantially the real value of said interests, though requested so to find and though such facts were material and fully established by evidence. (Petitioner's proposed Finding No. 22.)

(5) Said board erred in that it failed to find that on March 11, 1916, approximately 240 acres out of 1,000 acres of mineral land leased by the Mahoning Ore & Steel Company were being actively operated, though requested so to find and though such fact was material and fully established by evidence. (Petitioner's proposed Finding No. 25.)

(6) Said board erred in that it failed to find that the annual production from the properties leased by the Mahoning Ore & Steel Company would necessarily vary from year to year, based upon conditions in the steel business and upon the needs and requirements of the majority stockholders of said Mahoning Company for the ore produced by that company, though requested so to find and though such facts were material and fully established by evidence. (Petitioner's proposed Finding No. 29.)

(7) Said board erred in that it failed to find that it was impossible in 1916 to determine with reasonable certainty the future annual

production of the Mahoning Ore & Steel Company, though requested so to find and though such fact was material and fully established by evidence. (Petitioner's proposed Finding No. 30.)

65 ERRORS IN FAILING TO MAKE WRITTEN FINDINGS OF FACTS ON WHICH BOARD RELIED IN THE DETERMINATION OF DEFICIENCIES

(8) Said board erred in that it failed to make and to include in its written findings of fact a specific finding on whether or not the obligation of the Youngstown Company under the contract of March 11, 1916, had a fair market value at that date, such finding being necessary to a decision of the question before said board, and said board being required by law to make such specific written finding of fact.

(9) Said board erred in that it failed to make and to include in its written findings of fact a specific finding as to the alleged present market value in dollars at March 11, 1916, of said obligation of the Youngstown Company, such finding being necessary to a decision of the question before the board, and the board being required by law to make such specific written finding of fact.

(10) Said board erred in that it failed to make and to include in its written findings of fact a specific finding of the respective proportions of return of capital and taxable income held by it to be represented by each payment made to petitioner by the Youngstown Sheet & Tube Company under said contract of March 11, 1916, such finding being necessary to a decision of the question before said board,
66 and said board being required by law to make such specific written finding of fact.

(11) Said board erred in that it failed to make and to include in its written finding of fact a specific finding of the recoverable ore content at March 11, 1916, of the lands leased by the Mahoning Ore & Steel Company and of the life of said deposits from March 11, 1916, upon which factors said board purported to predicate its value of the obligation of the Youngstown Company under the contract of March 11, 1916, though such factors were required to be determined under the method pursued by the board in purporting to determine the value of said obligation, and the board being required by law to make such specific written findings of fact.

ERRORS IN STATING FACTS AND EVIDENCE RELIED UPON BY THE BOARD IN ITS OPINION IN DECIDING THE CAUSE

(12) Said board erred in assuming and relying on the assumption that it could determine with reasonable accuracy the future annual production of the Mahoning Ore & Steel Company, in tons, when in fact such production was determinable only at will of the directors of that company.

(13) Said board erred in stating in its opinion and relying upon said statement in deciding the issue, that no evidence had been ad-

duced before the board to prove the inaccuracy of the commis-
67 sioner's estimate of 82,858,535 tons of ore as of March 11, 1916,
the evidence clearly establishing the inaccuracy of said esti-
mate.

(14) Said board erred in assuming and relying on the assumption that the commissioner's determination in fixing the deficiencies in this case that the life of the ore reserves of the Mahoning Ore & Steel Company would be 45 years from March 11, 1916, was correct, when the undisputed evidence shows that since fixing the deficiencies in this case the commissioner in a proceeding to redetermine the depletion rate of the Mahoning Ore & Steel Company found that the life of said mine was 40 years from March 1, 1913.

(15) Said board erred in stating in its opinion that the obligation of the Youngstown Company had a definite present fair market value at March 11, 1916, said statement not being supported by a finding of fact and being contrary to the evidence adduced before the board.

(16) Said board erred in stating in its opinion that there was no evidence before the board to show that the obligation of the Youngstown Company could not have been disposed of except at a substantial sacrifice, evidence having been adduced by petitioner clearly establishing that said obligation could not have been sold except at such a sacrifice.

(17) Said board erred in stating in its opinion that

"What happened in 1916 was that certain stock was sold
68 for $2,200,000 and a contract which the respondent determined
had a fair market value at date of receipt of $1,942,111.46,
which value we have approved for lack of evidence showing error on the part of the respondent in making such determination,"

said board having made no finding of the market value of said contract and the evidence before said board clearly establishing that no fair market value could be determined for the obligation of the Youngstown Company under said contract.

(18) Said board erred in stating in its opinion that one of the respondent's witnesses (meaning E. J. Stack) had taken part in formulating the commissioner's determination as to probable life of and as to the tonnage of ore in the mine, whereas it appears from the testimony of said witness on cross-examination that he had no part in fixing the valuation in this case and was never in the Mahoning property before 1925.

ERRORS IN ADMISSION OF EVIDENCE

(19) Said board erred in admitting in evidence any testimony and statement of facts tending to show the estimate of the ore content of lands leased by the Mahoning Ore & Steel Company and the average annual future production from said lands and the estimated life of the mineral content of said lands from March 11, 1916, said evidence

being incompetent, irrelevant, and immaterial on the question
69 of the present fair market value in 1916 of the obligation of the Youngstown Company under the contract of March 11, 1916, and said evidence having been duly objected to by attorneys for petitioner.

(20) Said board erred in admitting in evidence testimony and statements of facts that the present worth of the sum of $5,965,814.52, discounted at 6%, with provision for sinking fund at 4% over 45 years, was on March 11, 1916, $1,942,111.46, said evidence being irrelevant and immaterial, since the evidence shows that the estimate of $5,955,814.52 would not be received in equal annual installments over a period of 45 years, and said evidence having been duly objected to by attorneys for the petitioner.

(21) Said board erred in admitting in evidence testimony with respect to whether or not there was a possible market for iron-ore mines in the Mesaba Range of Minnesota, said evidence being incompetent, irrelevant, and immaterial on the question of whether or not the obligation of the Youngstown Company had a present fair market value in 1916, and said evidence having been duly objected to by attorneys for petitioner.

ERRORS IN CONCLUSIONS OF LAW

(22) Said board erred in holding, solely upon the basis of an estimate of ore reserves and hypothetical future production derived from data compiled for the purpose of fixing a depletion rate as at March 1, 1913, for Mahoning Ore & Steel Company and con-
70 trary to the competent and uncontroverted evidence adduced before it, that the obligation of the Youngstown Company had a determinable fair market value at March 11, 1916.

(23) Said board erred in holding that the opinions of expert witnesses and the other evidence before the board were insufficient to establish that the obligation of the Youngstown Company had no fair market value on March 11, 1916, said evidence being fully competent to establish that fact and said evidence being uncontradicted and fully establishing that fact.

(24) Said board erred in holding that the making of the contract of March 11, 1916, was a closed transaction in respect of which loss or gain might arise and that the performance of that contract was a separate transaction or series of transactions from which gain arose.

(25) Said board erred in that it treated the contract of March 11, 1916, as a gain or loss transaction for that year, as above mentioned, and at the same time refused to allow the petitioner to recover the value of property determined by the board to have been received by her, before taxing petitioner further with respect to that property.

(26) Said board erred in its method of determining the income of petitioner from the payments made by the Youngstown Company

under said contract, in that said board failed to allow to petitioner a return of the cost or March 1, 1913, value, or other basis as provided by law before determining the taxable net income of petitioner.

(27) Said board should have held that petitioner was entitled under the sixteenth amendment to the Constitution and the revenue act of 1918 to recover the cost or other basis to her of the obligation of the Youngstown Company under the contract of March 11, 1916, before she should be deemed to have realized income from any payments to her pursuant to that obligation.

(28) Said board erred in determining that of the payments received by petitioner as follows:

1918	$15,750.00
1919	32,383.80

the following, or any part thereof, represented taxable net income:

1918	$10,623.38
1919	21,733.85

(29) The board erred in holding that the amount of ore to be mined annually over a period of years was susceptible of determination, although such a conclusion was not warranted by the evidence adduced before it.

(30) Said board erred in approving as the fair market value of the obligation of the Youngstown Company an amount computed by the commissioner solely upon the basis of an estimate of ore reserves and hypothetical future production derived from data compiled for the purpose of fixing a depletion rate as at March 1, 1913, for Mahoning Ore & Steel Company, it appearing from the finding of fact and uncontroverted evidence as to annual production that the commissioner subsequently to computing the deficiencies made an entirely different and necessarily inconsistent and conflicting estimate of future production in a proceeding in which he redetermined and changed the depletion rate for Mahoning Ore & Steel Company.

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(31) Said board erred in holding that the gross amount received by the petitioner from Youngstown Sheet & Tube Company under the contract of March 11, 1916, represented royalties received and includable in gross income, and that the petitioner was entitled to an allowance of a deduction therefrom under section 214 (a) (8) of the revenue act of 1918, when in fact such receipts were not royalties and were not gross income under the revenue act of 1918.

(32) Said board erred in that, although in determining the capital value of the obligation of the Youngstown Company under the contract of March 11, 1916, it had assigned different capital values to each estimated annual payment varying according to the time when it would in theory be received, it ignored these capital values when it came to determine the amount which should be considered a return of capital on each annual payment as and when payments were re-

ceived and held that a fixed proportion of each payment 60 cents (determined by dividing the fair market value of the obligation of the Youngstown Company at March 11, 1916, by the estimated
73 tons of ore in the reserves of the Mahoning Ore & Steel Company at that date) represented a return of capital.

(33) Said board erred in failing and refusing to give effect to the finding that the petitioner reported her income on the cash receipts and disbursements basis in that it treated as the equivalent of cash a mere contractual right and concluded that the receipt of a nonnegotiable agreement of the kind here involved for the contingent future payment of cash gave rise to taxable income or constituted a taxable closed transaction prior to the time income was received by petitioner in cash.

Wherefore your petitioner prays that this court may review the determination of the United States Board of Tax Appeals in this cause and reverse the decision of said board because of the errors aforesaid, and direct said board to redetermine the deficiencies against your petitioner on the basis that the obligation of the Youngstown Sheet & Tube Company under the contract of March 11, 1916, had no fair market value on that date; and/or that this court may direct and grant such other and further relief as to it may appear proper in the premises.

December 12, 1928.

WALTER M. ANDERSON,
Greenwich, Connecticut, Attorney for Petitioner.
RAYMOND B. GOODELL,
Attorney for Petitioner,
56 Pine Street, New York, New York.

74 [*Duly sworn to by Walter M. Anderson; jurat omitted in printing.*]

Now, October 3, 1929, the foregoing petition for review certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

75 Before United States Board of Tax Appeals

Docket No. 18202

JULIA ANDREWS BRUCE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Statement of evidence

Filed Sept. 30, 1929

The above cause came on for hearing before the Honorable Charles P. Smith, member of the United States Board of Tax Appeals, upon

the 17th day of January, 1928, there being present petitioners by their counsel, Mr. Tompkins, Mr. Ford, and Mr. Anderson, and respondent by his attorney, Mr. Mitchell.

The above cause at said hearing was consolidated for purposes of hearing and decision with the following cases then pending before the Board of Tax Appeals:

Edith Andrews Logan	Docket No.	5508
Henry W. Heedy	" "	5916
William J. Hitchcock	" "	5917
Frank Hitchcock	" "	5918
William M. Andrews	" "	6014
Carrie L. Shaw, executrix	" "	6436, 6437, 6438

76 Thereupon there was filed with the board the following agreed statement of facts. By agreement of the parties the same was received in evidence and made a part of this record.

AGREED STATEMENT OF FACTS

It is hereby stipulated and agreed by and between counsel for the taxpayer-appellant and the Commissioner of Internal Revenue in the above-entitled case that for the purpose of the hearing of said case the following facts shall be taken as true without the necessity of introducing evidence, subject, however, to the right of either party to raise the question of the materiality of any facts so stipulated.

1. Prior to March 1, 1913, and continuously to March 11, 1916, the taxpayer appellant owned 350 shares, and her mother, Louisa Andrews, owned 1,180 shares, of the capital stock of the Andrews & Hitchcock Iron Company, an Ohio corporation, which, at all said times mentioned, had 4,000 shares of capital stock issued and outstanding.

2. The Andrews & Hitchcock Iron Company at all times between the 1st day of March, 1913, and the 11th day of March, 1916, owned, among other assets, a 12% interest in the capital stock of the Mahoning Ore & Steel Company, which controlled, under a lease dated April 1, 1895, and running for 97 years after said date, an
77 iron mine located on the Mesaba Range in Minnesota, known as the Mahoning mine.

3. On the 11th day of March, 1916, all the stockholders of the Andrews & Hitchcock Iron Company, including the taxpayer appellant and her mother, Louisa Andrews, entered into a certain written contract with the Youngstown Sheet & Tube Company, an Ohio corporation, providing for the sale of their stock in the Andrews & Hitchcock Iron Company to the Youngstown Sheet & Tube Company, a true copy of which contract is hereto attached, marked "Exhibit 1," and hereby made a part of this stipulation as if specifically written herein, together with a true copy of a certain written contract dated December 16, 1914, by and between the stockholders of the Mahoning Ore & Steel Company, which contract of December

16, 1914, was by reference made a part of said written contract of March 11, 1916.

4. On March 22nd, 1917, Louisa Andrews, the taxpayer's mother, died, leaving a last will and testament, which was duly admitted to probate, and under which the taxpayer received by bequest a 550/4000ths interest in any payments that might subsequently become due under the said contract, Exhibit 1.

5. The value of the said 550/4000ths interest so acquired by the taxpayer under her mother's will was fixed by the Commis-
78 sioner of Internal Revenue for the purposes of Federal estate tax imposed upon the estate of Louisa Andrews at $277,164.50.

6. The value on March 1, 1913, of the 350 shares of stock of the Andrews & Hitchcock Iron Company owned by the taxpayer and sold by her under said contract, Exhibit 1, was in excess of the sum of $234,703.70 and exceeded the cost of said shares to her.

7. Since the sale of said 350 shares under the contract, Exhibit 1, the taxpayer has received the following sums on account of the purchase price of said stock down to and including the year 1919:

1916	$192,500.00	(Taxpayer's share of the $2,200,000 paid in cash under said contract, Exhibit 1.)
1917	13,860.00	
1918	15,750.00	
1919	12,593.70	

8. The total of the sums received by the taxpayer as a result of the sale of said 350 shares of stock owned by her under the contract, Exhibit 1, down to and including the year 1919, was less than the value on March 1, 1913, of the 350 shares of stock sold.

9. Since the death of her mother, Louisa Andrews, on March 22, 1917, the taxpayer, down to and including the year 1919, has
79 received the following sums under said contract, Exhibit 1, on account of the 550/4000ths interest in the future payments under said contract acquired by her under her mother's will:

1917	Nothing.
1918	"
1919	$19,790.10

10. The total of the sums so received by the taxpayer since her mother's death, by virtue of the 550/4000ths interest in the future payments under said contract Exhibit 1, acquired by the taxpayer under her mother's will, was less than the value of the said 550/4000ths interest fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax upon the estate of Louisa Andrews, and less than the value of said interest at the date it was acquired by inheritance from her mother.

11. The taxpayer, between March 1, 1913, and December 31, 1919, kept no books, and her returns for Federal income-tax purposes for the years 1916 to 1919, inclusive, were made upon the basis of cash receipts and disbursements.

12. A difference of opinion existed between engineers and experts employed by the Mahoning Ore & Steel Company on the one hand,

and by the Commissioner of Internal Revenue on the other,
80 both qualified by education and training in the iron mining industry, as to the estimated annual production of said mine and its life as of March 11, 1916.

13. Engineers employed by the commissioner, qualified by education and training in the iron mining industry to give such opinions, estimated that at the date of the contract of March 11, 1916 (Exhibit 1 attached hereto) that the ore reserves of the Mahoning Ore & Steel Company were 82,858,535 tons; that the average annual future production from said mine would be 1,841,300 tons; and that the life of the mine was 45 years from March 11, 1916.

14. The estimate mentioned above and adopted by the commissioner in this case was based upon data obtained from the Mahoning Ore & Steel Company and the estimate furnished by that company's engineers, given in a proceeding to fix the depletion rate for the Mahoning Ore & Steel Company. It was based upon the content of recoverable ore in only approximately 620 acres out of the entire property leased by the company.

15. Since fixing the deficiency in this case, the Commissioner of Internal Revenue in a proceeding in which the depletion rate for the Mahoning Ore & Steel Company was changed, based upon data furnished by the company and the opinions of duly qualified
81 engineers and experts employed by him, found that the life of said mine was forty years from March 1, 1913, and that the estimated ore reserves of said mine on March 1, 1913, was 88,561,533 tons. The tonnage mined from said Mahoning mine from the 1st day of March, 1913, to the 11th day of March, 1916, was 5,039,655 tons.

16. The actual ore mined annually in tons for the Mahoning Ore & Steel Company between 1913 and 1926, inclusive, was as follows:

1913	1,515,428	1920	1,720,537
1914	1,212,287	1921	803,020
1915	2,311,940	1922	1,011,204
1916	2,215,788	1923	3,029,865
1917	2,525,144	1924	1,717,092
1918	2,019,481	1925	1,690,138
1919	1,217,167	1926	1,813,811

17. Assuming that the said Mahoning mine had ore reserves on March 11, 1916, of 82,858,535 tons, and further assuming that all said ore was mined, and 12%, thereof, namely, 9,942,664.2 tons, were delivered to Youngstown Sheet & Tube Company, the total
82 amount which would be received under the provisions of the contract of March 11, 1916, Exhibit 1, by all the vendors of said stock and their successors in interest would be the sum of $5,965,814.52, at the rate of 60¢ per ton.

18. The present worth of the sum of $5,965,814.52 based upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6%, with provision for a sinking fund at 4%, was on March 11, 1916, $1,942,111.46.

(Signatures.)

WASHINGTON, D. C., *January 17, 1928.*

Exhibit 1 to agreed statement of facts

This agreement made and entered into at Youngstown, Ohio, this 11th day of March, A. D. 1916, by and between Louisa Andrews, Julia Andrews Bruce, Edith Andrews Logan, W. J. Hitchcock, Frank Hitchcock, H. W. Heedy, and the estate of U. A. Andrews, parties of the first part, hereinafter called the stockholders, and the Youngstown Sheet & Tube Company (an Ohio corporation), party of the second part, hereinafter called the Youngstown Company:

Witnesses that whereas said stockholders are the owners of all the capital stock of the Andrews & Hitchcock Iron Company (an
83 Ohio corporation), and the Youngstown Company is desirous of purchasing all of said stock for the benefit of itself and others, as hereinafter designated, upon the terms and conditions following:

Now, therefore, it is agreed by and between said parties as follows, to wit:

First. The stockholders, for themselves and their respective heirs, representatives, and assigns, agree with the Youngstown Company, for itself, its successors, and assigns, that they will sell, assign, transfer, and set over to the Youngstown Company and the others hereinafter designated all of said capital stock of said the Andrews & Hitchcock Iron Company, and the Youngstown Company agrees that it will purchase said stock for itself and said others hereinafter designated and pay therefor to the Dollar Savings & Trust Company, of Youngstown, Ohio, for the benefit of said stockholders, the sum of one thousand dollars ($1,000.00) cash in hand upon the execution and delivery of this agreement, receipt whereof is hereby acknowledged; the further sum of two million one hundred ninety-nine thousand dollars ($2,199,000.00) on the 11th day of April, A. D. 1916; and the further sum in amount and manner to be determined as provided in paragraph 4 hereof.

Second. Said stockholders further agree that forthwith upon the execution and delivery of this contract they will deliver or
84 cause to be delivered to said the Dollar Savings & Trust Company all of said capital stock, properly assigned, and that they will cause said the Dollar Savings & Trust Company to deliver the same to said the Youngstown Company and others upon the payment of said sum of two million one hundred ninety-nine thousand dollars ($2,199,000.00) to said the Dollar Savings & Trust Company on said 11th day of April, as above provided, it being the intention of the parties that the title to said stock shall pass to and vest in the Youngstown Company and said others upon the making of said payment on April 11th, 1916, and that delivery of said stock and the making of said payment shall be simultaneous.

Third. It is understood that the capital stock of said the Andrews & Hitchcock Iron Company is four hundred thousand dollars ($400,000.00), divided into four thousand (4,000) shares of the par value

of one hundred dollars ($100.00) each, and that the same is owned by said stockholders in the following several proportions:

Louisa Andrews	1,180	shares.
Julia Andrews Bruce	350	"
Edith Andrews Logan	250	"
W. J. Hitchcock	1,000	"
Frank Hitchcock	1,000	"
H. W. Heedy	100	"
Estate of U. A. Andrews	120	"

It is further agreed that said the Dollar Savings & Trust
85 Company shall deliver said stock to said the Youngstown Company and others as follows:

To the Youngstown Company	3,993	shares.
To James A. Campbell	One	"
To Richard Garlick	One	"
To C. S. Robinson	One	"
To William E. Manning	One	"
To L. J. Campbell	One	"
To C. D. Hine	One	"
To E. L. Ford	One	"

Fourth: It is understood that said the Andrews & Hitchcock Iron Company is the owner of twelve per cent, or three hundred sixty (360) shares of the capital stock of the Mahoning Ore & Steel Company, a corporation of the State of Pennsylvania, having a capital stock of three hundred thousand dollars ($300,000.00), divided into three thousand (3,000) shares of the par value of one hundred ($100) each, which said Ore & Steel Company is the owner of certain valuable mines for the production of iron ore, and that the said the Andrews & Hitchcock Iron Company, by an agreement in writing in quintuplicate, bearing date of December 16th, 1914, is entitled to take each year a full quota of each grade of ore to be produced by said Ore & Steel Company in proportion to the amount of stock owned by or represented for it, as provided for in said agreement, a copy of which is hereto attached, and marked "Exhibit A" for the purpose of making the same a part thereof; and for the purpose of fixing the balance of the purchase price to be paid
86 by the Youngstown Company, it is therefore further agreed between said parties as follows, to wit:

That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of ore to which the said the Andrews and Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the terms of said written agreement of December 16th, 1914, and shall give the notice provided for in said agreement, and will pay or cause to be paid to said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price, each year on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2,240)

pounds of iron ore so entitled to be taken for such year, and actually delivered by said Ore and Steel Company, it being understood that if any part of the quota for any year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof.

Fifth: In order to secure the making of said deferred payment of said purchase price, as provided for in paragraph fourth, it is further agreed between the parties that said three hundred and sixty (360) shares of Ore & Steel Company stock shall be properly
87 assigned and deposited in the hands of said the Dollar Savings & Trust Company as collateral security therefor, and shall be held until all of the balance of said purchase price is fully determined and paid.

If at any time the Youngstown Company fails to pay punctually any installment of said purchase price as it falls due, and such default continues for the period of thirty days after written notice and demand therefor made by the stockholders, or any of them, then any of said stockholders, in addition to any other lawful remedy, may elect to take and keep as and for his own, his proportionate share of said Ore and Steel Company stock to which his pro rata holdings of the stock of said the Andrews & Hitchcock Iron Company, as herein set forth, may entitle him, and shall have the further additional right to recover any and all costs, expenses, damages, and attorney fees suffered or incurred by him in premises.

It is further understood and agreed that the Youngstown Company will pay all costs, charges, and expenses, including attorney fees and compensation of the Dollar Savings & Trust Company connected with the making of this contract, and the full and complete performance of the trust herein provided for, it being the intention of the parties that said stockholders shall receive said sum of sixty cents per ton for ore and all other sums herein made payable to them, free and clear from any costs or expense whatsoever incident to the making or carrying out of this agreement.

88 Sixth. All payments made by the Youngstown Company to said the Dollar Savings & Trust Company shall be by it forthwith distributed and paid over to the stockholders in shares proportionate to their stockholdings in said the Andrews & Hitchcock Iron Company, as above set forth in paragraph third hereof.

Seventh. The rights and liabilities of the parties hereto shall extend to and be binding upon their respective heirs, or successors, administrators, executors, and assigns.

In witness whereof, the parties have signed or caused their names to be signed to triplicate hereof the day and year first above written.

(Signatures.)

Exhibit A to agreement

AGREEMENT

(Executed in quintuplicate)

(Being Exhibit A referred to in the foregoing Exhibit 1.)

Made this 16th day of December, 1914, by and between the present stockholders of the Mahoning Ore & Steel Company, said company having a capital stock of $300,000.00, divided into three thousand (3,000) shares each of $100.00 par, issued and held as follows:

Name	Shares	Percentage
John A. Topping, trustee (representing Republic Iron & Steel Co.)	180	6%
Frank Hitchcock, trustee (representing the Andrews & Hitchcock Iron Co.)	360	12%
Leonard C. Hann	65	
D. R. Hanna	63	
A. M. Robbins	33	
Simon Perkins	65	
C. C. Bolton	43	
Samuel W. Folsom	10	
L. C. Hanna and D. R. Hanna	80	
M. Andrews (represented by L. C. Hanna and C. C. Bolton, trustees)	1	12%
D. G. Kerr (representing Carnegie Steel Company)	1	
Carnegie Steel Company	599	20%
W. H. Donner	1,498	
Effingham B. Morris	1	
Herbert F. Black (representing Cambria Steel Company)	1	50%
	3,000	100%

Whereas, by agreement bearing date 26th of April, 1897, between representatives of the National Tube Company, Andrews & Hitchcock Iron Company, Mahoning Valley Iron Company, Andrews Brothers Company, and Cambria Iron Company, it was agreed that the capital stock of the Mahoning Ore Company was held for the use of the said five manufacturers and consumers of ore, as follows:

National Tube Works Company	20%
Andrews & Hitchcock Iron Co.	12%
Mahoning Valley Iron Company	6%
Andrews Brothers Company	12%
Cambria Iron Company	50%

and it was provided that each of said manufacturers and consumers should be entitled to take its proportional part of the total output of ore mined per annum from the mines of said company at the cost of production and delivery as therein fixed and determined;

And whereas the Mahoning Ore & Steel Company was organized in pursuance of the provisions of said agreement and took over all leaseholds, property, and assets of the Mahoning Ore Company;

And whereas since the date of said agreement, there have been transfers of said capital stock of the Mahoning Ore & Steel Company and changes in the ownership thereof by and with the approval

of all the parties in interest, and it is desirable to restate the respective interests as they now stand and more clearly provide for disposal of the ore produced from the mine of the said Mahoning Ore & Steel Company;

Now, therefore, this agreement witnesseth that the entire capital stock of Mahoning Ore & Steel Company being now held as hereinbefore stated, each of the parties in interest hereby agrees that the base agreement bearing date of April 26th, 1897, be, and
91 hereby is, terminated, and that in lieu thereof the following terms and conditions shall hereafter govern the method whereby the iron ore produced from mines of said company shall be disposed of.

First. The tonnage of each grade to be produced annually shall be fixed by the board of directors on or before April 1st, in each year, and notice of the fixing of said tonnage shall be mailed promptly to each stockholder.

Second. Each of the interests, as hereinbefore set forth, shall be entitled to take a full quota of each grade to be produced, in proportion to the amount of stock owned by or represented for them, and within 15 days after receipt of notice referred to in preceding paragraph, shall notify in writing the president of said Mahoning Ore & Steel Company whether or not it elects to take the full quota to which it is entitled. Undesired tonnage, if any, shall be offered pro rata to the other stockholders, and such portion thereof not desired by them can be disposed of by the board of directors by reducing the originally fixed production to the extent of the unaccepted tonnage, or in any other manner the board of directors may agree upon.

Third. The price of ores shall be fixed each year by the board of directors and shall be at or about the cost of production, including all costs, transportation, delivery, handling, etc., to the lower Lake ports. Delivery elsewhere with corresponding modification in price,
92 may be arranged in special instances, subject to the approval by the board of directors.

Fourth. Formal contracts shall be entered into annually with the company covering the tonnage and grade of ore which each interest or representative shall have elected to take, in accordance with the provisions of this agreement, and as estimated cost price will be named in said contract, based on preceding section, subject to adjustment to actual cost at end of ore season.

In witness whereof this agreement has been executed by the parties hereto the day and year above written.

D. C. KERR,
For Carnegie Steel Company.
THE ANDREWS & HITCHCOCK COMPANY,
By FRANK HITCHCOCK, *Pt.*
W. H. DONNER,
E. B. MORRIS,
HERBERT F. BLACK,
Representing Cambria Steel Co.

L. C. HANNA,
C. C. BOLTON,
As Trustees.
JNO. A. TOPPING,
Trustee, Republic Iron & Steel Co.

There was then offered and received in evidence, as petitioner's Exhibit No. 1 a copy of the contract of sale between the stock-
93 holders of the Andrews & Hitchcock Iron Company, on the one part, and the Youngstown Sheet & Tube Company, on the second part, dated March 11, 1916, and which forms part of the agreed statement of facts as Exhibit 1 thereto and which is fully above set forth.

Thereupon, under the reservation to either party of the right to raise a question as to the materiality of any facts agreed upon, as set out in the agreed statement of facts hereinabove set forth, attorneys for petitioner entered objections to the 13th, 14th, 15th, and 18th paragraphs of said agreed statement of facts, as follows:

Objections to stipulation

"Mr. TOMPKINS. On behalf of Edith Andrews Logan, under the rights of objection raised to the stipulation, I object to the 13th paragraph of the stipulation, upon the ground that it is incompetent, irrelevant, and immaterial, and has no bearing on this proceeding; that the test here is not as to the value of the Mahoning mine, but as to whether the obligation of the Youngstown Sheet & Tube Company, under the contract of March 11, 1916, to make future payments, could be sold, whether a purchaser could be found so as to make it a closed transaction or not, and that, as matter of law, it would be error to value the contract and treat it as a closed transaction based upon the estimates made by the engineers merely as to the life of the mine. The test here is whether the obligation of the Youngs-
94 town Sheet & Tube Company to pay 60¢ per ton for the ore under this contract could be sold and disposed of, whether there was any purchaser that could be found in the market in 1916 that would be ready and willing to pay cash or the equivalent of cash for that obligation. It is to preserve our legal rights that I make that objection.

* * * * * * *

"The MEMBER. As I understand it, there is no objection raised to the actual fact.

"Mr. TOMPKINS. Yes, sir; that is right.

"Mr. FORD. That is right.

"Mr. TOMPKINS. No; there is no question about that.

"The MEMBER. The record will simply show your objection to it. I do not see that it is necessary for me to rule upon it at the present time.

"Mr. TOMPKINS. If you rule later adversely to us, of course, you will save us an exception?

"The MEMBER. Yes; that is correct.

* * * * * * *

"Mr. MITCHELL. And the commissioner, in the event the objection is sustained, would also desire an exception.

"The MEMBER. That will be noted.

* * * * * * *

"Mr. TOMPKINS. May a similar objection be noted to this 14th paragraph? I suppose your honor will make a similar ruling.

"The MEMBER. Yes; that is correct.

95 "Mr. FORD (after reading paragraph 15 of the agreed statement of facts). A similar situation here arises, does it not?

"Mr. TOMPKINS. Yes.

"The MEMBER. A similar ruling.

* * * * * * *

"Mr. TOMPKINS. On behalf of the taxpayers we object to paragraph 18 of the proposed stipulation upon the ground that it is irrelevant and immaterial and has no bearing on the case, and that the contract of March 11, in evidence here, and the record as to actual tonnage show that this sum of $5,965,814.52 would not be received in equal annual installments over a period of 45 years.

"The MEMBER. I make the same ruling in this instance that I did in the other.

"Mr. TOMPKINS. The same ruling with reference to taking an exception?

"The MEMBER. Yes."

* * * * * * *

Said member later overruled said objection to the 13th, 14th, 15th, and 18th paragraphs of the agreed statement of facts, hereinabove fully set out, and duly noted exceptions on behalf of petitioner to said rulings.

Thereupon there was offered and received in evidence, as petitioner's Exhibit No. 2, a statement by the Commissioner of Internal Revenue attached to his notice of deficiency and identified by the symbols, IT:PA:1-VMW-104-60D, the material portions of which are as follows:

96 *Petitioner's Exhibit 2*

In re: Mrs. Edith Andrews Logan, 814 Stambaugh Building, Youngstown, Ohio

	Deficiency in tax	Overassessment
1915 (claim filed)		$18.60
1916 "		1,441.15
1917 "		491.73
1918 (waiver filed)	$994.05	
1919 "	14,277.92	
1920	6,776.66	
Totals	22,048.63	1,951.48

Your income-tax liability has been adjusted in accordance with the recommendation of the former committee on appeals and review as follows:

* * * * * * *

1916

* * * * * * *

From a reconsideration and audit of the information and data on file it is disclosed that no profit was realized in 1916 from the sale of the Andrews and Hitchcock Iron Company stock to the Youngstown Sheet and Tube Company, and, accordingly, the profit, as computed by the revenue agent who verified your return, has been excluded therefrom. A portion of the receipts from the ore shipments in subsequent years, however, is taxable, the basis of which is set
97 forth in the statement showing the tax adjustment for year 1917 and subsequent years, returns.

* * * * * * *

1917

* * * * * * *

Add to net income reported on original return:

Ore payments of $9,900.00 received, less return of capital of $3,222.45 ..... $6,677.55

You are advised that your taxable income from ore payments has been determined in accordance with the recommendation of the Committee on Appeals and Review. The following depletion schedule has been computed in accordance therewith:

DEPLETION SCHEDULE

Year	Receipts from ore	Tons paid for	Sustained	Depletion allowed	Claimed by omission
1917	$9,900.00	16,500	$3,222.45	$3,222.45	$9,900.00
1918	11,250.00	18,750	3,661.48	3,661.48	11,250.00
1919	28,785.60	47,976	9,478.14	9,478.14	28,785.60
1920	17,421.79	29,036	5,736.35	5,736.35	17,421.79

* * * * * * *

1918

* * * * * * *

Add to net income reported on original return:

Ore payments received from Youngstown Sheet and Tube Company, $11,250.00, less return of capital thereon of $3,661.48 ..... $7,588.52

* * * * * * *

98 The ore receipts from the Youngstown Sheet and Tube Company less the return of capital thereon have been included as income as shown herein under the statement showing the income and tax adjustment for 1917.

* * * * * * *

1919

* * * * * * *

Add to net income reported on original return:

Ore receipts of $28,785.60 received from Youngstown Sheet and Tube Company, less return of capital thereon of $9,478.14 ..... $19,307.46

* * * * * * *

The inclusion of the receipts of $28,785.60 in gross income, representing your share of the ore payments by the Youngstown Sheet and Tube Company with a deduction therefrom of $9,478.14, representing a return of capital, is based on the schedule in the statement following your tax adjustment for 1917.

* * * * * * *

1920

* * * * * * *

Add to net income reported on original return:

Ore receipts from the Youngstown Sheet and Tube Company of $17,421.79, less return of capital thereon of $5,736.35 ..... $11,685.44

* * * * * * *

99 The inclusion in gross income of the receipts from the Youngstown Sheet and Tube Company representing your share of the ore shipments with a deduction of $5,736.35, representing a return of capital, is based on the explanation of this transaction in

the statement following the adjustment of your net income and tax liability for 1917.

* * * * * * *

Thereupon, there was offered and received in evidence as petitioner's Exhibit No. 3, the recommendation of the committee on appeals and review of the Bureau of Internal Revenue dated February 4, 1924, as follows:

Petitioner's Exhibit 3

Recommendation No. —

Committee on Appeals and Review

In re: Appeal of Mrs. Julia Andrews Bruce, North Street, Greenwich, Connecticut

Years 1917, 1918, 1919, and 1920

FEBRUARY 4, 1924.

Mr. COMMISSIONER:

(For Deputy Commissioner, head Income Tax Unit.)

The committee has carefully considered the appeal of Julia Andrews Bruce, Greenwich, Connecticut, from the action of the
100 Income Tax Unit in proposing to assess additional taxes for the years 1917 to 1920, inclusive, predicated in part upon adjustments of net income hereinafter outlined.

Oral hearing was accorded the representative of appellant on January 16, 1924.

Appellant was the owner of 350 shares of a total of 4,000 shares of the capital stock of the Andrews and Hitchcock Iron Company. The latter company owned 360 shares, or 12%, of the entire outstanding capital stock of the Mahoning Ore and Steel Company.

Under an agreement bearing date of December 16, 1914, between the Mahoning Ore and Steel Company and its stockholders, the latter were entitled to take, at or about the cost of production, including all costs, transportation, delivery, handling, etc., to lower lake ports, a full quota of each grade of ore produced by the company in proportion to the amount of stock owned by or represented for them.

On March 11, 1916, the stockholders of the Andrews and Hitchcock Iron Company contracted to sell to the Youngstown Sheet and Tube Company all of their holdings in the former company for $2,200,000 cash, of which amount there was paid upon execution and delivery of the agreement $1,000, and $2,199,000 on April 11, 1916, and a further consideration set out in the contract as follows:

"That the Youngstown Company shall, and will each year hereafter, take or cause to be taken the full quota of ore to which
101 the said the Andrews and Hitchcock Iron Company, its successors or assigns, may be entitled, under and by virtue of the

terms of said written agreement of December 16th, 1914, and shall give the notice provided for in said agreement, and will pay or cause to be paid to the said the Dollar Savings & Trust Company for the benefit of said stockholders, and as the balance of said purchase price, each year on or before thirty days after the close of navigation to the transportation of ore on the Great Lakes, the sum of sixty cents (60¢) per ton for each and every ton of twenty-two hundred forty (2,240) pounds of iron ore so entitled to be taken for such year, and actually delivered by said ore and steel company, it being understood that if any part of the quota for any year be left at the mine by election of the Youngstown Company, the Youngstown Company shall pay on account thereof to the stockholders in the same manner as though the same had been shipped from the mine, but shall not thereafter be required to pay any additional sum on account thereof."

The contract sets forth that it is "the intention of the parties that the title to said stock shall pass to and vest in the Youngstown Company and others upon the making of said payment on April 11, 1916, and that delivery of said stock and the making of said payment shall be simultaneous." The contract further provides that the
102 360 shares of stock of the Mahoning Ore & Steel Company owned by the Andrews and Hitchcock Iron Company were to be properly assigned and deposited in the hands of the Dollar Savings and Trust Company as collateral security "until all of the balance of said purchase price is fully determined and paid," and that in the event of default in the payment of any installment continues for a period of 30 days after written notice and demand therefor by the vendors, or any of them, then any of said vendors, "in addition to any other lawful remedy, may elect to take and keep as and for his own his proportionate share of said Ore and Steel Company stock to which his pro rata holdings of stock of said the Andrews Hitchcock Iron Company may entitle him."

Upon the death of her mother, which occurred on March 22, 1917, appellant inherited a one-half interest in her mother's estate, including a 550/4000 interest in the contract of March 11, 1916. The value of this interest for the purpose of the Federal estate tax has been appraised at $277,164.50.

As deferred payments on the purchase price of her holdings in the Andrews and Hitchcock Iron Company there was paid to appellant under the terms of the contract heretofore quoted the following amounts:

1917	$13,869.00	1919	$32,383.80
1918	15,750.00	1920	19,599.53

The appellant reported none of the above receipts as income
103 on her tax returns, but rather treated them as a return of capital, on the theory that she was entitled to recover the March 1, 1913, value of the stock sold and the fair market value at the date of acquisition of the 550/4000 interest in the contract of March 11, 1916, acquired by inheritance before reporting any receipts as income for tax purposes.

The Income Tax Unit has determined the total ore reserves in the mines of the Mahoning Ore and Steel Company on April 1, 1916, to have been 82,858,535 tons, and the life of the mines as 45 years from that date. On the basis of an ownership of 12% of the capital stock of the Mahoning Ore and Steel Company, the unit reasons that the total tonnage of ore to be delivered to the Andrews and Hitchcock Iron Company will amount to 9,943,024.2 tons which, at the rate of $0.60 per ton, will yield payments amounting in the aggregate to $5,965,814.52 to the former stockholders. The present worth at April 1, 1916, of such payments, assuming that the same will be paid in equal annual installments, discounted at 6% with provision for a sinking fund at an equivalent rate compounded annually, the unit finds to be $2,049,018.65. As the appellant received a 350/4000 interest in the contract of March 11, 1916, as a part of the purchase price of her stock, the unit further finds that the present worth at April 1, 1916, of her expected receipts was $179,289.13. Therefore, the unit finds that this amount of $179,289.13 plus $192,500, cash (350/4000 x
$2,200,000) or $371,789.13, was the consideration appellant
104 received in 1916 for her stock, and as this selling price was more than the cost of such stock and less than the March 1, 1913, value thereof, the unit further finds in accordance with Treasury Decision 3206 that appellant realized no gain or loss from the sale of this stock in 1916.

Out of every $0.60 received by appellant as deferred payments during the years under consideration on her 350/4000 interest in the contract of March 11, 1916, the unit has held that 20.6 cents constitutes a return of capital, while 39.4 cents constitutes taxable income. The unit has accepted the value of $277,164.50 for the 550/4000 interest acquired by inheritance, as appraised for the purpose of the Federal State tax, and has held that out of every $0.60 received by appellant as deferred payments during the years under consideration on this 550/4000 interest, 20.86 cents constitutes a return of capital, while 39.14 cents constitutes taxable income.

The appellant contends that this sale of stock should be treated as a sale of personal property partly for cash and partly for a deferred consideration, and since the obligations represented by the deferred payments have no readily realizable market value the amounts received would be applied to reduce the "basis" of the property sold and be taxable only, if, when, and to the extent that they ultimately exceed the "basis."

In support of this contention, reference is made to article 46 of Regulations 62 and S. M. 1353 and O. D. 482 (2 C. B. 77). Should this contention be rejected, then the appellant presents as an alternative that property was exchanged for a contract "calling for
105 a series of annual payments, or, in other words, for an annuity contract, in which event the case would fall under article 47 of Regulations 62, which provides that the amounts received under an annuity contract in excess of the premium or price paid therefor is income for the year of its receipt."

It should be noted here that the Income Tax Unit and the appellant are in accord with respect to the cost of appellant of her 350 shares of capital stock of the Andrews and Hitchcock Iron Company sold in 1916 and the March 1, 1913, value thereof.

The issues presented to the committee for determination may therefore be briefly summarized as follows:

(1) Is the Income Tax Unit correct in holding that the sale of this stock was a complete transaction in 1916, notwithstanding the fact that the transaction involved deferred payments extending over an estimated period of 45 years; and

(2) If the unit's action with respect to the first issue is correct, how are the deferred payments, as and when received, to be treated for income-tax purposes?

Under the provisions of article 26, par. 171, Regulations 33, revised, it was mandatory upon appellant to render her return for the year 1916 on the basis of cash receipts and disbursements. Therefore, unless it can be shown that the obligations of the purchaser were
equivalent to cash, the transaction could not be regarded as
106 having been completed in 1916 and the appellant would be
entitled to treat the same as a sale of personal property on the installment plan, as outlined in article 42, Regulations 45 (1920 edition). See O. D. 715 (3 C.B. 107). On the other hand, if it can be demonstrated that the obligations of the purchaser were equivalent to cash, then the proper rule to be followed under such circumstances would appear to be that set forth in article 1664 (a), Regulations 45 (1920 edition), as amended by Treasury Decision 3206, and the case would fall within that provision of article 42, Regulations 45 (1920 edition) as amended, which states that "occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25%) that the sale, though involving deferred payments, is not one on the installment plan."

It is with difficulty that a rule may be laid down as to when property may be said to have a fair market value. Each case must stand upon its own merits and be judged in the light of its own peculiar facts.

It implies the existence of a public of possible buyers at a fair price. The adjective "fair" emphasizes the idea of fairness inherent in the conception of market value and excludes any possibility of a construction of the words "market value" with reference to a market in which, or to circumstances of sale under which, for any reason, a fair price could not be obtained.

Having in mind the principle above enunciated and review-
107 ing all of the facts peculiar to the instant case, the committee is clearly of the opinion that the 350/4000 interest in the contract of March 11, 1916, received by the appellant as a part consideration for her holdings in the Andrews and Hitchcock Iron Company had a determinable and assignable fair market value when received

by her in 1916, and that such interest ought to be regarded as equivalent to cash. The contract of December 16, 1914, between the Mahoning Ore and Steel Company and its stockholders was iron-bound, and in the absence of any specific provision in the contract relating to the period of time covered by it, it is a reasonable presumption that it applied to the total contents of the Steel Company's mines as and when produced. The contents of those mines can be and have been readily determined. Likewise was the contract of March 11, 1916, between the Youngstown Sheet and Tube Company and the former stockholders of the Andrews and Hitchcock Iron Company equally iron-bound and assured to the latter deferred payments equivalent to $0.60 per ton on 12% of the total ore reserves of the Steel Company's mines. The deferred payments were secured by the 360 shares of the capital stock of the Steel Company owned by the Andrews and Hitchcock Iron Company which had been placed in the hands of a trustee for that purpose, and under the terms of the contract by virtue of which these shares were deposited with the trustee, the stockholders were assured that in the event of default in any of the deferred installments by the purchaser of the stock they
108 would receive their pro rata shares of the ore produced by the Steel Company by exercising their option to take over the collateral security. There can be no doubt but what, under the circumstances, the interest of each stockholder could be converted into cash without any material loss. The initial cash payment was in excess of 25% of the total selling price. The committee is, therefore, of the opinion that the sale by appellant in 1916 of 35[illegible] shares of the capital stock of the Andrews and Hitchcock Company for cash and deferred payments constituted a closed and completed transaction of that year.

The committee is of the opinion that the unit's computation of the present worth at April 1, 1916, of the appellant's 350/4000 interest in the contract of March 11, 1916, should be revised to the extent of providing a sinking fund at 4% rather than 6% as used by the unit. The result of this revision will show a present worth of $169,934.73 in lieu of $179,289.13 as computed by the unit.

The question of the manner of treating the deferred payments, as and when received, for income-tax purposes, presents no serious difficulties. It is obvious that if in computing gain or loss upon the transaction when completed in 1916, the appellant is given the benefit of a market value for her interest in the contract, which is based upon the discounting of the gross deferred payments at the rate of 6%, then in reaching a conclusion as to how the deferred payments, when received, shall be treated for income-tax pur-
109 poses, the computation should merely be reversed and the deferred payments allocated to a return of capital in the same ratio as the total deferred payments bear to their discounted value and the balance of such deferred payments reported as income. Therefore, of every dollar received represented by the 350/4000 in-

terest, $0.32554 represents a return of capital and $0.67446 constitutes taxable income. Of every dollar received represented by the 550/4000 interest acquired by inheritance, $0.33099 represents a return of capital and $0.66901 constitutes taxable income.

Accordingly, it is recommended that the action of the Income Tax Unit be modified as herein indicated; and that the appeal be denied.

(Signed) COMMITTEE ON APPEALS AND REVIEW.

Approved:

(Signed) D. H. BLAIR,
Commissioner of Internal Revenue.

"Mr. FORD. I am not attempting to offer the closing letters in the other cases, because these are being offered for the purpose of showing the particular method of computation adopted in the department, and they are similar in so far as that is concerned.

* * * * * * * *

"Mr. FORD. As I understand it, all of the stipulations are received?

"The MEMBER. Yes; that is correct."

110 Thereupon the following testimony was heard:

FRANK HITCHCOCK, having been first duly sworn as a witness on behalf of petitioner, upon direct examination, testified as follows:

My name is Frank Hitchcock, and I live in Youngstown, Ohio. I was formerly a stockholder and officer of the Andrews & Hitchcock Iron Company, and immediately before March 11, 1916, was president of that company. I negotiated, on behalf of the stockholders of the Andrews & Hitchcock Iron Company, the contract of March 11, 1916, entered into between those stockholders and the Youngstown Sheet & Tube Company. Mr. Campbell negotiated the contract on behalf of the Youngstown Sheet & Tube Company. He was then president of the Youngstown Sheet & Tube Company. His father was there, and Richard Garlick, but it was Mr. Campbell who did the talking. There were some other directors with Mr. Campbell at the time. The Andrews & Hitchcock Iron Company owned 12 per cent of the stock of the Mahoning Ore & Steel Company.

"Q. Referring to this contract of March 11, 1916, and the provision that some $2,200,000 be paid in cash, I will ask you whether that consideration of $2,200,000 was in payment indirectly for certain of the assets of the Andrews and Hitchcock Iron Company.

"Mr. MITCHELL: Just a moment. I object to that as call-
111 ing for a conclusion and as not the best evidence. The contract itself shows what the payments were for and what they were made for.

* * * * * * *

"The MEMBER. The objection is overruled. * * * An exception will be noted.

* * * * * * *

"A. They were."

Those assets comprised some small properties in Michigan. Some of them have turned out to be pretty good since then, but at that time they were pretty poor, I thought. They also included blast furnaces in Ohio, coal lands in Pennsylvania, and moneys in the bank. At that time these represented practically all the assets they had, outside of the value of the Mahoning Ore & Steel Company stock. There was no discussion at all to the effect that the present cash payment represented the interest of the Andrews & Hitchcock Iron Company in the Mahoning Ore & Steel Company stock.

"Q. Why did you not bring up any discussion as to a present cash payment for that interest?

* * * * * * *

"A. Being a minority stockholder, I did not think it was—I mean the Andrews and Hitchcock Iron Company being a minority stockholder in the Mahoning Ore and Steel Company, I did not think there was any chance of getting a cash value for the property and did not bring it up, as to its worth. I mean cash value as to its worth.

112 "Q. Mr. Hitchcock, at that time, namely, March 11, 1916, did you know of any market where you could have obtained or did you know of any market where could be sold an interest of 12 per cent of the stock of the Mahoning Ore & Steel Company?—A. No; not at its value.

* * * * * * *

"Q. Mr. Hitchcock, in 1916 was there any price established by public sale or sales in the way of ordinary business of similar contracts to this contract of March 11, 1916, in which the fair market value of the contract at that time, at the time it was made, could be determined?

"Mr. MITCHELL. Objected to as calling for a conclusion of the witness.

"A. No.

"The MEMBER. Objection overruled * * * an exception noted.

"Q. Was there in 1916 any general market for contracts of this character and any established or current market price?—A. No.

"Mr. MITCHELL. The same objection.

"The MEMBER. The same ruling.

"Mr. MITCHELL. Exception."

Upon cross-examination FRANK HITCHCOCK testified as follows:

I was president of the Andrews & Hitchcock Iron Company
113 in 1916, before I sold out, and had been president since about January, 1900. My position in the iron industry made me familiar with the larger transactions that went on in that industry.

I don't remember the sale of the Chemung mine and I do not know where the Chemung mine is. I do not know anything about the sale of the Kosmerl mine and I do not know where that mine is. I do not know the Eva mine or the Ruth mine and I don't know any of those names just at present.

In 1916, and for a few years before that, I had my office at Youngstown, Ohio. My duties required me to go up on the Mesaba Iron Range. I was up there two or three times a year, maybe oftener. It would depend altogether on what was going on then. We got monthly reports all the time. I made short trips, in going over the property and other properties. The name Tener mine is familiar, but I don't remember at the present time just what the transaction was involving that mine. I don't know the sale prices of any mine at or around 1916. I know there were mines sold there, but I don't know about 1916, just exactly right there. When mines were sold I did not inquire into the circumstances nor familiarize myself with the transaction except in a general way. I am not aware of the fact that the United States Steel Corporation was buying mines during or around that time. They were interested in iron mines, in the Mahoning mine.

"Q. Did I understand you to say that you did not think
114 there was any chance of getting the cash value of the Mahoning property?—A. Yes; I said that. There was no chance of getting the cash value, on account of the minority holdings.

"Q. When you sold out did you feel that you had not obtained the cash value?—A. When we sold out? We did not get through this contract—we expected to get the cash value.

"Q. Do you mean by your answer that you did not think you could get the cash value; you did not think you could get a payment in cash, the entire payment in cash?—A. We did not get the entire payment in cash.

"Q. You do not mean to say that you were not getting a fair value for your property, did you?—A. No.

"Q. You meant that you were getting it over a considerable term of years?—A. Yes."

I think that the United States Steel Corporation has bought some iron ore properties which collectively are as big as the Mahoning mine. I would say that that company and other large companies of the same sort sometimes did buy large ore properties. The United States Steel Company bought most of the properties, and they were put together. They bought the Oliver Mining Company, which is still in business.

"Q. Well, I understood you to say that you did not know of any market where 12 per cent of the Mahoning Ore & Steel Company stock could be sold at its value.

* * * * * * *

"A. Not for its cash value.

115 "Q. Not for cash value; and you mean by that not for the full purchase price in cash?—A. In cash; yes.

"Q. But you are not prepared to say that there was no market existing in which a reasonable value could be obtained, partly in cash and partly over a period of years; you are not prepared to say there was not that sort of a market, are you?—A. I did not know of any."

JOHN B. PUTNAM having been first duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

My name is John B. Putnam, and I reside at Cleveland, Ohio. I am connected with Pickands, Mather & Company, in Cleveland. They are a steel company, a partnership. They operate iron and ore mines, and have coal, pig iron, and vessel interests. They have approximately 35 iron-ore properties in their different companies. I am generally familiar to-day with iron-ore leases and contracts covering the taking of iron ore. I have looked over the contract marked petitioner's Exhibit #1, dated the 11th day of March, 1916, between certain stockholders of the Andrews and Hitchcock Iron Company and the Youngstown Sheet and Tube Company.

"Q. In 1916, was there any price established by public sales, or sales in the way of ordinary business of similar contracts, by which the fair market value of this contract of March 11, 1916, petitioner's Exhibit #1, at the time it was made, can be determined?

116 "Mr. MITCHELL. I object to all that as calling for a conclusion of the witness, whose qualification to answer has not yet been established.

"The MEMBER. The objection is overruled * * * exception noted.

"A. I know of no such market for such contract.

"Q. Was there in 1916 any general market for contracts of that character or any established or current market price?

"Mr. MITCHELL. Same objection.

"The MEMBER. Overruled.

"Mr. MITCHELL. Exception.

"A. Not that I know of.

"Q. In your opinion, could the vendors—that is, the sellers of this contract, petitioner's Exhibit # 1, in 1916, on any sale of this contract—have readily realized in cash or its equivalent its real value?

"Mr. MITCHELL. The same objection.

"The MEMBER. The objection is overruled; exception will be noted.

"A. I think not.

"Q. Why not? Give your reason.

"Mr. MITCHELL. The same objection.

"The MEMBER. The same ruling; an exception noted.

117 "A. The real value of that contract depends upon two things, in my judgment. It depends, first, upon the total

amount of iron ore that will be taken out and taken by the Youngstown Sheet & Tube Company, and, second, upon the rate at which they will take that ore. All of the properties owned by the Mahoning Ore & Steel Company have not been explored, and the tonnage is not definitely ascertained, so that you would have a considerable amount of uncertainty as to the total amount of tonnage which would be shipped under the contract, and which would measure the payment of 60 cents a ton.

"In addition to that, there is no minimum in the contract, and there is no control by the purchaser or seller of that contract over the amount that will be shipped each year.

"The amount of ore under this contract and the stockholders' agreement to take the ore, which is referred to in there, is left to the control of the board of directors of the Mahoning Ore & Steel Company. They would determine each year how much ore would be taken from the property and therefore how much these payments would be, and their determination each year would, of course, have to be dependent upon the conditions and needs for this particular kind of ore of the controlling stockholders of the company. Those conditions vary widely with the other sources of supply of ore which those stockholders have. The conditions of the steel business, how much the consumption of that ore was, and particularly of these ores here—the particular consumption of this particular ore
118 by those stockholders would, of course, depend upon the kind of pig iron and the kind of steel they wanted to make.

"I am not an expert in metallurgy or what these ores would be good for, but I have had enough contact with the ore business to know that particular ores are used for particular purposes, and if the controlling stockholders have a large use for this particular kind of ore, they would probably fix the production higher than if they had a relatively small use for this particular kind of ore. They might have other ore supplies, which would have to be taken into consideration.

"Of course, the iron and steel business is notoriously a business of feast and famine, as you call it; so you would have ups and downs.

"For example, the total production of the Lake Superior district in 1917, as I recall it, was about sixty-three million odd tons. In 1921 it dropped down below thirty million tons—twenty-three millions tons, I think it was. You have those fluctuations in the total ore shipped from that district, and naturally you have to expect probably relatively larger fluctuations in the production of any one mine, which would be affected not only by the general conditions but by the specific conditions with reference to that mine and that particular ore.

"I might also say in addition to that that I believe it is customary—indeed, it has been our experience—that iron-ore mines and leases and anything that is dependent for its value upon the
119 total volume of iron ore, the rate of production, and so forth, are not customarily sold for cash. There have been sales of

iron ore mines, but I am not familiar with any, except in a general way, but the most universal practice in the Lake Superior district is to transfer title or permit the development of an iron ore property through leases and contracts, which run over a period of years and vary their payments with the total volume of ore taken out from the mines and the annual rate of production. In my judgment, from the acquaintance I have had with it, that is the natural outgrowth of this kind of a situation, that the true value of those things can only be determined after the total ore reserves have been developed and shown and after you have been through the experience and determined what the actual production is going to be.

"Now, I do not mean by that that it has no value, and I do not mean by that that you can not arrive at some value for it; but so far as the cash sale value goes, customarily those contracts and interests in iron ore properties are not dealt in in that way."

Upon cross-examination, JOHN B. PUTNAM further testified:

"Q. You find that iron ore properties are ordinarily sold with the terms of payment closely related to the expected production; is that the idea?—A. No; they are customarily leased. You are referring now to a property owned in fee, where the owner wants it developed and the ore disposed of?

120 "Well, let us deal just with sales for the minute. When iron ore properties are sold, has it been your experience that payment ordinarily follows the expected rate of production and expected life? For instance, if the mine sold is expected to have a life of 20 years, will you ordinarily find that payments are spread over 20 years?—A. I do not know of any sales of iron ore properties, except a sale that I heard about generally, which Jones & Laughlin made to the Cleveland Cliffs Iron Company, of a small property on the Marquette Range. They sold that for cash a good many years ago, in connection with the sale of a lot of timber lands up there.

"In addition to that, however, we have two properties, I think it is—two small properties in the Menomonee Range, buying a minority interest in the fee. Generally, in those cases, the thing comes up through the properties being inactive. They are subject to leases which have small minimums, and they get into the hands of some estates. They come to us with the lease, and they ask us to buy the fee.

"Those are the only cases I know of where the fees of properties have been sold for cash."

I never heard of the United States Steel Company buying fees of ore properties for cash recently. If you include in a sale a situation of this kind—the Biwabik Mining Company, you might say, bought the fee of one of the forties of their mine, and they did it in this way: They took and bought it, and they gave back a contract which obligated them to pay so much a ton on every ton of ore they

121 took out. Now, if you call that a sale, I have known of that one. I do not know as I have known of any others outside of that one.

I never heard of the sale of the Eva or Ruth mine to the United States Steel Company, nor did I ever hear of the Eva or Ruth mine. I never heard of the Kosmerl mine. I have heard of the purchase of iron ore property by Henry Ford or his associates. I understand he bought the Imperial mine in fee.

"Q. Well, is it not true that there is a possible market for iron ore properties in the Mesaba Range to such interests as the United States Steel and Henry Ford, or similar interests?

"Mr. TOMPKINS. Just a moment. I object to that, on the ground that it is incompetent, irrelevant, and immaterial to the issue in this case. It is not as to whether there is any market for an iron ore mine in the Mesaba Range but as to whether this contract of March 11, 1916, had any value or whether there was any market for the deferred obligations under the contract.

"The MEMBER. The objection is overruled.

"Mr. TOMPKINS. Exception.

* * * * * * * * *

"A. In my judgment there is no market for a cash sale for any large or really valuable iron ore mine. Now, that sale of the Imperial mine to Henry Ford—there was an old mine, which
122 three or four different operators had tried to make go but had thrown it up. It was a poor quality of ore, poorly developed, and poorly situated, and, as you know, Mr. Ford has found it impossible himself, with his efficient methods, to make it go. I do not think that would be a precedent for any other purchasers, and, as a matter of fact, Mr. Ford has now taken another property up there which I understand he has christened the Blueberry. He has taken that by lease. I think if the Imperial mine had been a really valuable mine, which the fee owners considered had a real value, they would never have gotten together on a cash price."

I have heard of the Leetonia mine. I never heard of that mine being sold. I heard indirectly one time that Jones & Laughlin had bought the stock of that company, as I recall it, or they had acquired all the stock or all the interest in the mine or lease in some form through acquiring either the stock of the mining company that held the lease or the stock of one of those furnace companies down there that had the lease. It was a complicated thing, and I do not remember the details of it, but I am quite sure it was not a sale of the mine. It is not my understanding that they went into the transaction without owning the mine and came out of it owning the mine. I think they just owned the lease. I do not think there is any question but what the Mahoning mine could be sold; I do not think there is any question but what it could be sold for cash or for cash payments over a period of years. What I have in mind is
123 this, if I can make myself clear; I do not believe a seller not under coercion of some kind would ever part with his interest in the Mahoning mine for a cash consideration which would be as low as a buyer would pay for it, and the proof of the fact that that does

not exist is that normally in that district these interests are transferred under these, you might call them, installment contracts, although they are not installment, because the total amount is left open and indefinite.

They are ordinarily sold with payments spread over the term of years, or a substantial part of the payments, and with the total amount left indefinite and conditional upon the amount of ore extracted and the rate of payment is conditional upon the rate of extraction. I think undoubtedly there are some developed properties where the total amount of ore is pretty definitely known.

I would say Pickands, Mather & Company operate about thirty-five mines. In my connection with that company I have something indirectly to do with Federal tax matters, but that is not my specialty. In my connection with Federal tax matters I have found it necessary to fix the cash market value as of March 1, 1913, for those mines. We have to do so on every property and on every lease that we owned on March 1, 1913.

I am 35 years of age. There is no question but what, if you have to fix a value, in my judgment, you can value any of these; you can value any contract; you can value any mine lease; but the result of our efforts to value our mining leases for depletion on
124 March 1, 1913, has been demonstrated in a great many cases. We have come down here and we have set up a certain value, and the department has discounted it, and finally gotten down to a figure that we could persuade them to take.

Now, in many cases which I could name to you it has turned out that all of the tonnage has not been valued; all of the value has not been given. We have actually shipped out of those mines a good deal more in certain cases already; and in more numerous cases we have developed more ore and now have in sight tonnages, which, when taken with the production we have shipped since 1913, will give a considerably larger tonnage than was valued at March 1, 1913. That does not mean, of course, that the properties did not have a value on March 1, 1913. It means that it had a considerably larger value—a considerably greater value—than was granted by the department, but we just had to take these lower values because of this kind of a market situation that you have that results in these leases.

I am familiar with the Mahoning property in a general way. I have been there and I know what the holdings are, just in a general way. I am not an engineer. I just know, in a general way, that out of about one thousand and odd acres of land a certain part of it is generally explored and a certain part of it is not.

125 J. C. AGNEW, having been first duly sworn as a witness on behalf of petitioner, upon direct examination testified as follows:

My full name is J. C. Agnew, and I live in East Aurora, New York. I am a mining engineer. I have been connected with the Mahoning Ore & Steel Company, and first entered their employ in 1904 as an

engineer. I was connected with that company until about April 1, 1923. About 1912 I was made general superintendent of the Mahoning Ore & Steel Company. On approximately January 1, 1919, I was made assistant to the president of the Midvale Steel & Ordnance Company and also a director of the Mahoning Ore & Steel Company.

The Midvale Steel & Ordnance Company acquired a half interest in the Mahoning Ore & Steel Company through its acquisition of the Cambria Steel Company; I think that was about 1915 or 1916.

The Midvale Steel & Ordnance Company was a combination of various companies, of which one was the Cambria Steel Company. The mine of the Mahoning Ore & Steel Company is located near Hibbing, in St. Louis County, Minnesota, on the Mesaba Range. I was resident at the mine until the 1st of January, 1919, or the later part of 1918.

In 1916 approximately one thousand acres of mineral property was owned by the Mahoning Ore & Steel Company. At that date about six forties (six 40-acre sections), approximately 240
126 acres, were under operation or had ore taken from them. As to the remaining properties, some had been explored in whole or in part. The entire property never had been explored. I would say that in addition to that portion that was in operation about one-third had been either pretty well explored, fairly explored, or you could see some evidence of tonnage around the edges, but not sufficient to determine the tonnage. In addition to those six forties that I have spoken of, I would say that there was probably another 60 or 80 acres that was quite thoroughly explored. Of that thousand, between 400 and 500 acres had either been totally or practically unexplored.

The Mahoning Ore & Steel Company did not own the fee of that property; they had a 99-year lease. From my familiarity with that property and my employment with the company I am able to state concerning the period up to 1909 or 1910 whether the company had any definite policy as to the amount of annual production. Up until that time the policy was one of conservation. At a production of 1,000,000 to 1,500,000 tons, and all the physical conditions that existed at the Mahoning mine, a very reasonable cost of production could be obtained. Also at about 1,000,000 or 1,500,000 tons, their royalty at 1,500,000 had reached its minimum of 12½ cents.

I am familiar with the State tax situation prior and subsequent to 1909 or 1910. About 1906 or 1907 taxes were very reasonable on the Mesaba, and commencing about 1907 they commenced to rise
127 very rapidly. Take this Mahoning Ore & Steel Company. The taxes had risen from about $40,000 in 1906 to about $244,000 in 1912, and to about $482,000 in 1916.

This policy of conservation, existing prior to about 1909 or 1910, underwent a change. That change took place about 1911, as I remember, occasioned by two things: First, the fact that the presidency of the Cambria Steel Company passed into the hands of Mr. Donner.

The Cambria Steel Company was a 50 per cent. owner in the Mahoning ore industry, and it was determined that more of this ore should be used at the Cambria plant at Johnstown, Pennsylvania, so that a plan was laid out for increased stripping and general equipment of the property so that this increase requirement could be met. This increased stripping took place about 1911, 1912, and 1913.

The plan was to put the mine in position to produce 3,000,000 tons a year. It was put in that position. I might say that about that time a contract was made between the Cambria Steel Company and the Pennsylvania Steel Company by which the Pennsylvania Steel Company had the right to take from the Cambria Steel Company ore from this mine to the extent of a portion of their requirements at Steelton, with a maximum requirement on the part of the Pennsylvania Steel Company, as I recollect it, of a half million tons. Mr. Donner also was president of the Pennsylvania Steel Company.

From my familiarity with the Mahoning Ore & Steel Company property and the business and physical conditions surrounding
128 it, at about March 11, 1916, I could not estimate with reasonable certainty the expected future production of that mine by years, annually.

That mine was the property of the various shareholdings, interests that, I believe, had been mentioned here, all of whom were consumers of the ore. The production of the property was determined from year to year, based on their needs, and their needs fluctuated for any number of reasons—business conditions, changes in their own practices, rearrangements of their own ore affairs, so it was very difficult to predicate any production. Our position as operators of the mine was at all times to be ready to meet their requirements.

In my opinion, general business conditions of the steel company had an effect on the annual production of the Mahoning mine. In times of depression it would be reflected in the production from the mine. The production of the mine would fall. In times when business was good, the production would be up. Of course, during the war those things were restricted more or less by distribution.

The effect of the European war, as I could foresee it, at about March 11, 1916, of course caused an upward tendency on the annual production of the Mahoning mine, but I think it was in 1917 or 1918 that the Railroad Administration stepped in, and we were limited. Our people wanted something over 3,000,000 tons, but our tonnage was reduced, in my opinion, to about 2,500,000 tons. The production in 1921 is typical of an extreme fluctuation—303,000 tons.

129 In March of 1916 you could not tell with reasonable accuracy the total content of ore in all of Mahoning Company's ore properties. That had something to do with the extent of the exploration. There were between four or five hundred acres of property on which the exploration was either not made or else the exploration was not sufficiently clear to give any estimate.

"Q. Well, as to the part of the property explored, do you think that could be determined with reasonable accuracy as to the amount of tonnage?—A. That is about three hundred acres out of the entire thousand.

* * * * * * *

"Q. Mr. Agnew, you have seen this contract of March 11, 1916, petitioner's Exhibit No. 1 [handing same to the witness]?—A. Yes.

"Q. In 1916 was there any price established by public sales or sales in the way of ordinary business of similar contracts by which the fair market value of that contract at the time it was made could be determined?—A. No.

"Mr. MITCHELL. I object to that as calling for a conclusion.

* * * * * * *

"The MEMBER. The objection is overruled * * * an exception is noted.

* * * * * * *

"Q. Was there in 1916 any general market for contracts of that character and any published or current market price for the same?—A. Not to my knowledge.

130 "Mr. MITCHELL. The same objection.

"The MEMBER. The same ruling * * * an exception will be noted.

* * * * * * *

"Q. In your opinion, could the vendors or the sellers under that contract or any sale of the contract have realized in 1916 in cash or its equivalent its real value?

"Mr. MITCHELL. The same objection.

"The MEMBER. The same ruling.

"A. No; I do not think so.

"Mr. MITCHELL. Exception."

Upon cross-examination, J. C. AGNEW further testified:

Attorney for respondent handed the witness a map (respondent's Exhibit A), with reference to which the witness testified as follows: This map shows the location of the Mahoning property. The main property to which I referred is there in those eight forties [indicating on map]. Now, there is a 60-acre tract right here [indicating on map]. Then there are two in here [indicating on map]. Now, there are three forties in section 19, right next to the Itasca County line. There are two forties near the St. Paul line, again in Itasca County. Then there is one other isolated 40-acre piece.

(Said map was then offered and received in evidence and
131 marked "Respondent's Exhibit A," a true and correct copy of which is attached hereto.)

(The witness then, upon request of attorney for respondent, marked on said map (Exhibit A) the lands of the Mahoning Ore & Steel Company in 1916, and stated at the same time that there are three forties in Itasca County that are not marked on it.

(The attorney for respondent also handed to witness a second map (respondent's Exhibit B), prepared from descriptions of the Minnesota authorities, with respect to which, witness testified as follows:)

This map (Exhibit B) shows the location of a portion of the principal ore lands of our company in 1916. They are the principal ones now. The portion set out on this map includes the part which was being actively operated in 1916.

(The map was then offered and received in evidence as "respondent's Exhibit B," a true and correct copy of which is attached hereto.

(The witness continued to testify as follows:)

I am not familiar with the Federal income and profits tax matters in which the company was involved while I was general superintendent. I am familiar with the tax situation between the company and the State of Minnesota. The State of Minnesota found an ore content only in the land set out on respondent's Exhibit B. It did not value on an ore content basis any of the company's lands other than the land set out on Exhibit B.

Both the Minnesota Tax Commission and the Federal Gov-
132 ernment arrived at their knowledge of this property from explorations made by the company itself. Neither the Minnesota Tax Commission nor the Federal Government ever did any drilling or exploration on this property. The tax commission got data * * * I can not speak so well for the Federal Government * * * from all of the companies which in any way had worked around this property, so that they had more information than we, as a company, had, and with the information thus obtained, the Minnesota Tax Commission put a tonnage on these properties. They put a valuation on the properties. That does not mean, as I interpret it, that there was no tonnage there. It simply means that, whatever you did, you would simply be putting a valuation on the ore; so why not just value it as mineral and, which the Minnesota Tax Commission had a perfect right to do. They could value your property either on the basis of your tonnage or they could simply value it as land. The Minnesota commission did not attempt to find any tonnage on the land not shown on Exhibit B. That also applied to the United States, i. e., the Federal Government only found tonnage on the lands shown on Exhibit B.

When I said a little while ago that in 1916 one could not tell with reasonable accuracy the tonnage content of ore, my answer applied to the entire holdings. I do not think that in 1916 the total content of ore in the lands disclosed by Exhibit B could be estimated with reasonable accuracy. Of the lands shown by Exhibit B, I would pick
133 lots 2, 3, and 4 in section 1, lots 1, 2, and 3 in section 2, the northwest quarter of the southeast quarter of section 2, the north half of the southwest quarter of the southeast quarter of section 2, as being the only lands, in my opinion, in which the ore contents could be determined with reasonable accuracy. Those lands

include all of the lands in sections 1 and 2, except the northeast quarter of the northeast quarter of section 1 and the northwest quarter of the northwest quarter of section 2. I want to qualify that statement, however. There are in the area which I outlined as fully explored certain areas which are not fully explored, but they are within the operating area. My statements apply only to the portion of the section marked in black on Exhibit B.

Now, as to the land shown by Exhibit B, where I said the ore content could not be ascertained with reasonable accuracy, that situation existed because there was not sufficient exploration. There were really three sorts of exploration that had been done there. The first was the old work, which was originally done back in 1893 or 1894 or 1895, consisting of test pits, and that touched the ore and was the basis on which this property was selected originally. Then as time went on the properties were put in operation adjoining this area in sections 3 and 10, so that you could go there and see, standing out on the line. There were, I think, something like 15 or 20 drill holes put down in this property subsequent to that.

"Q. You mean by 'this property', the company's holdings in sections 3 and 10?—A. 3 and 10.

134 "Q. 15 to 20 drillings?—A. That is my recollection."

The adjoining land was being mined, or had been mined in 1916, so that you could see something of the ore that lay on these properties. You could see it along the boundary line.

"Q. Well, take the two 40-acre parcels in sections 1 and 2, which you say were not susceptible of an accurate determination. Is it not true that the company's own workings adjoined both of those parcels?—A. Yes, sir; it did."

We had something like 15 or 20 drill holes on each of those two 40-acre parcels. Our company had an open pit in the six 40-acre parcels lying along the north line of sections 1 and 2.

The operation of our company's mine as it existed in 1916 was what is commonly known as stripping. The ore was covered by a glacial drift, and this drift was taken off and removed by steam shovels, and taken out and dumped. Then the iron ore was loaded by steam shovel right into the railroad car for transportation. Everything was standard gauge. I do not know whether that is enough of a picture of it. We had an open pit something like a mile and a half long, and in some places the width was approximately 1,300 feet. The Mahoning Ore & Steel Company's property happened to be a portion of one of the biggest ore deposits of the Mesaba Range.

Adjoining those eight forties, the United States Steel Company was conducting an operation, known as the Hull Rust mine. To the east of it, there is the Sellers mine, operated by the

135 United States Steel Corporation, and if you want to trace out that pit you will be going beyond the realms of my knowl-

edge. I had nothing to do with their operations. I am trying to talk to you as an operator on the Mahoning Ore & Steel Company's property, and when we reached that point we were done. That is the limit. If you include the property operated by the United States Steel Company, you can conceive of an opening standing where we are now, and looking off there for a distance of pretty nearly two miles, with very irregular sides, and probably a portion of it is three-quarters of a mile wide. Throughout that area there are stripping operations going on, taking out the overburden, and then there are shovels and locomotives and railroads and all of the activities that go to making up the mining of ore, drilling, and blasting. It is really quite a sight.

Of the holdings of my company as shown on Exhibit B, I made an estimate of the eight forties that I described and I have given my best opinion as to what was in the balance of it. When I speak of an estimate of a property like this, on which I was operating, let us understand each other clearly—I was making an estimate on which I had to perform. The ore not only had to be there, but it had to be there in quantity and in the grade that I said it would be there, and I had to produce it every year, as I said I would. That is what I mean by an estimate. Now, you can take this other property and you can do as the tax commission did; you can take all the area
136 around it and say this forty next to that produced so many tons of ore, and therefore it is reasonable to expect that this one would, and you can get a figure on it. You do not suppose that I tramped over all of that property for years without making my own guess as to how much tonnage it would produce. Of course I did, and, of course, I looked at every one of those forties. I knew them like I know a book. I made a guess of what was there, but it was a guess. In reporting to the stockholders, I would definitely advise them that as to eight quarters, I had given a fairly accurate estimate, and as to the others, I would advise them that it was merely a guess, because it might be my opinion, and Mr. Bill Jones, another engineer, might come up and say, "Agnew, I don't agree with you; it might be something else," and I could not refute it.

Before I would allow my opinions to be published, I would distinguish between my estimate and my guess. If I allowed my opinions to be published to the commissioner, I would distinguish in the same way.

(Upon request of attorney for respondent, a document, marked "Respondent's Exhibit C for identification," was then handed to the witness, who testified with reference thereto as follows:)

The paper marked for identification as "Respondent's Exhibit C" is my own affidavit. I signed that and swore to it. That affidavit sets out my opinion of the ore content on this land that we have been talking about.

(Said respondent's Exhibit C for identification was then offered and received in evidence as respondent's Exhibit C, which is as follows:)

137 *Respondent's Exhibit C*

STATE OF PENNSYLVANIA,
County of Philadelphia, ss:

J. C. AGNEW, being duly sworn, deposes and says that he resides in Ardmore, Montgomery County, Pennsylvania. That he is a mining engineer and is familiar with the development, exploration, and operation of the properties of Mahoning Ore & Steel Company, located in St. Louis and Itasca Counties, Minnesota, operated by said company under lease from Grant Iron Mining Company.

That deponent made estimates from time to time of the amount of stripping required to be done upon said properties, obtaining the information upon which such estimates were based from explorations and drillings made thereon. That from the estimates so made it appears that on March 1, 1913, on tract 1 (lots 1, 2, 3, and 4 of section 1, and lots 1, 2, 3, and 4 of section 2, of township 57, range 21), the stripping to be done aggregated 11,580,000 cubic yards. From the experience of deponent and the Mahoning Company in connection with the stripping of said property, deponent avers that an average cost of 22.4¢ per cubic yard is a fair estimate of the cost of stripping said property, making a total cost of the stripping remaining to be done thereon of $2,591,920. That the cost of stripping done on said property prior to March 1, 1913, was $1,893,790.81, making the total cost of stripping said property $4,485,710.81. The tonnage estimated in said property as of March 1, 1913, is 64,756,588 tons, and
138 there was mined out prior to 1913, 16,581,357 tons, making a total of 81,337,925 tons. Averaging the total cost of stripping over said tonnage gives an average cost of stripping of 5.5¢ per ton.

As to tract 2 (NW. quarter of SE. quarter and N. half of SW. quarter of SE. quarter of section 2, township 57, range 21), the stripping to be done on March 1, 1913, aggregated 1,500,000 cubic yards. Assuming a cost of 22.4¢ per cubic yard makes a total stripping cost of $336,000 for tract 2, or distributed over all of the tonnage in the property, 9,450,891 tons, gives an average cost of stripping of 3.55¢ per ton.

As to tract 3 (being SE. quarter of SE. quarter of section 3 and NE. quarter of NE. quarter of section 10, township 57, range 21), the stripping to be done on March 1, 1913, aggregated 13,500,000 cubic yards (each cubic yard of taconite in such computation being treated as three cubic yards of stripping). At a cost of 22.4¢ per cubic yard the total cost of stripping will be $3,024,000, or distributed over the tonnage in the property, 7,533,969 tons, gives an average cost of stripping of 40.1¢ per ton.

As to tract 4 (being N. half of NW. quarter and SE. quarter of the NW. quarter and NW. quarter of SW. quarter), the stripping to be done aggregated on March 1, 1913, 15,200,000 cubic yards (each cubic yard of taconite in such computation being treated as three

cubic yards of stripping). At a cost of 22.4¢ per cubic yard the total stripping cost will be $3,404,800, or at the rate of 31.8¢ per ton on the 10,709,600 tons alloted to the property.

139 From the information at hand as of March 1, 1913, we would estimate that tract 1 could produce 2,300,000 tons for a period of 25 years and that the tonnage remaining in tract 1 at the end of this 25-year period would be mined out in 5 to 6 years. This prediction is based on operating the property in such a way as to permit of producing 2,300,000 tons over the longest period possible, which would be accomplished by cleaning up or "scramming" the ore lying on the rock as mining operations progress and not postponing this "scramming" until the last possible moment. As a matter of fact, this policy has been followed in the past, although to date the number of places where the ore has been bottomed are very few, comparatively speaking. In view of the extent of this property, there is no reason why such a policy can not be followed out, and in our judgment it should be.

(Sgd.) J. C. AGNEW.

Sworn to before me this 20th day of November, 1920.

[SEAL.] (Sgd.) GRACE M. WOODRUFF,
Notary Public.

(The witness (Mr. Agnew) then continued his testimony as follows:)

The map (respondent's Exhibit B) sets out tracts 1, 2, 3, and 4, referred to in my affidavit.

(The witness then marked the map (respondent's Exhibit B) to indicate the respective tracts, and continued as follows:)

140 From an examination of my affidavit, I find that I made estimates of all four tracts shown on Exhibit B, and did not distinguish my estimate in any way. I did not distinguish my opinion as to the four tracts as between estimates and guesses. I made no distinguishing marks at all in this affidavit. From an examination of this affidavit, Exhibit C, I find that I have also given opinions of probable life of the portion of the company's holdings that were being actively operated. This is set forth in the third paragraph on page 2 of the affidavit as follows:

"From the information at hand as of March 1, 1913, we would estimate that tract 1 could produce 2,300,000 tons for a period of 25 years and that the tonnage remaining in tract 1 at the end of this 25-year period would be mined out in five to six years."

There was more difficulty in estimating a probable life for tract 2, tract 3, and tract 4, than there was for tract 1. This is an estimate of what it would be reasonable to assume that this tract 1 produced over the period from March 1, 1913. Now, that does not mean that if the stockholders wanted three or four million tons it could have produced it. It is merely an estimate of what they could produce. This estimate was made for purposes of depletion of that property,

and was stated as from March 1 to May 8, 1921. I was asked to make this estimate by the president of the company, in order that the company might prepare its case for depletion. That is what this estimate is. It is one estimate of the propable life of tract 1.

141 (Attorney for respondent then handed the witness another map (respondent's Exhibit D), with reference to which the witness testified as follows:)

This is a map of tracts 1, 2, 3, and 4 that we have been talking about and surrounding country. It sets out generally the drill holes and the mining pits in that country and as to that area. It is dated January 1, 1913, and was prepared by the engineers of the company.

(Said map was then offered and received in evidence and marked "Respondent's Exhibit D," a true and correct copy of which is attached hereto. Witness then continued to testify:)

I do not know what the date means, whether that was the date of preparation or not. There have been made here additions to the date and legend. Whether that is the date on which the map was made, or whether it is the date on which the map was to be used, I am not sure. The date January 1, 1913, is on it, and it would be my best information that this map was prepared for use in valuing the properties as of January 1, 1913, and would show the condition as of January 1, 1913.

As to tract No. 3, I find that almost all of the west side adjoins an existing pit, and that half of the east side of that tract adjoins an open pit. As to tract No. 4, I find that a quarter of a mile on the east side and a quarter of a mile on the north side adjoins an open pit.

As to tract No. 2, I find that considerable portions of the boundary of that tract adjoin an open pit. Tract No. 2 was not thor-

142 oughly explored. There is not much question about the tonnage in that, and this is simply corroborative evidence. As to tract 3 and tract 4, it was on such data as mentioned that the Minnesota Tax Commission prepared their tonnage estimate on each portion. My affidavit is dated in 1921. Probably you did not have the record here.

We drilled some holes on these properties to see whether the tax commission's estimate was too high. Such holes as we did drill indicated that the tax commission's estimate was a conservative estimate, and we stopped there. My affidavit is based not only on the data indicated by the map but on later explorations, and those later explorations indicate that the estimate in my affidavit was correct.

In estimating the future production of the Mahoning mine as of 1916, I think the first factor is, as I have stated, the physical condition of the property. The property was able to produce 3,000,000 tons or more, so far as the property was concerned. Now, the other phase of the situation is the one that I went into a little earlier in my testimony, of the various requirements and demands of these stockholders from time to time, and that you can only judge from their plans and from what they proposed to do. The general demand

for iron ore in the United States would be an important factor, but you are dealing here with one of the cheapest ores that are produced on the range, and you always have the other phase of the situation, that your steel company is striving for cost, and they might use
143 that ore, because there is a saving even when times are hard. It is not so important when they are making money, so you have all those things to balance there. The general demand in this country for iron ore would be an important factor. Another important factor would be the condition of the industry in this country; i. e., whether times were prosperous or otherwise. It has been my experience that the demand for iron ore bears a fairly close relation to the general prosperity of the country.

I am familiar with a publication called "The Iron Ores of Lake Superior," put out by Crowell & Murray. They are always kind enough to send me one. I would regard the figures set out in that book for yearly shipments from the Mahoning mine as reasonably accurate.

(Thereupon counsel for respondent read into the record the statement of yearly shipments of ore as shown by the book The Iron Ores of Lake Superior for a period from 1900 up to and including 1912:)

1900	911,021 tons.	1907	1,564,332 tons.
1901	765,872 "	1908	611,592 "
1902	1,038,645 "	1909	1,561,893 "
1903	1,009,446 "	1910	1,515,723 "
1904	706,325 "	1911	1,011,945 "
1905	1,001,661 "	1912	1,518,643 "
1906	1,274,232 "		

144 These yearly shipments of ore would for all practical purposes be equivalent to the annual production, and the record just read corresponds substantially with my own record.

I do not think that the record just read, coupled with the record of production set out in the stipulation, indicates that the production of this mine is on a pretty even basis. If you will continue on there you will see that there has been an increase.

"Q. Yes; and don't you find that increase is a steady and somewhat slow increase?—A. Well, you have the figures there. I would say that there were some pretty substantial jumps there. I have not the figures in front of me."

We have in these records of production that there was a change in policy in this mine along about 1912, 1913, or 1914. The 1912 production is 1,518,000 tons. In 1913 it was 1,500,000. In 1914, the beginning of depression, it was 1,212,000. Then we jump up to 2,300,000, an increase of 1,000,000 tons. Leaving out the depression here, there is an increase of 800,000. Then we went along 2,300,000, 2,200,000, 2,500,000. Then you get your postwar period, 1,200,000, 1,700,000, and getting into 1921 we only had 303,000. From the standpoint of the production, 1921 was the worst year in the history of this company after we got into active production.

I would not say that the period from 1913 up to 1926, inclusive, could be considered as a representative period, taking the period as a whole. I would say that for two reasons. You have your
145 war years there of 1917 and 1918, and then you have your post-war years there, and that is evidence again, you see, by 1923, where you get to 3,000,000 tons. It is pretty hard, I think, to make a statement that any past ten years is necessarily indicative of what the next ten would be on this property, because you have all of those changing factors there. For instance, this property in 1923 changed hands again. The interest which the Midvale Steel & Ordnance Company acquired from the Cambria Steel Company passed in 1923 into the hands of the Bethlehem Steel Company.

I don't know the maximum capacity of that mine in 1916. Up to 1914 or 1915 I could have shipped six or seven million tons per year, if anybody could have hauled it away from there. We had a capacity for 3,000,000 tons during a year, but it was not contemplated that the company would produce 3,000,000 tons a year. The company's plan or program which resulted in the stripping of 1912 and 1913 was to have the property always ready to supply to its stockholders at least 3,000,000 tons per year. Now, in order to do that there were certain periods of war involved in the proposition that I do not know we need to go into here, but you had to have sufficient area and sufficient equipment so that in addition to producing this 3,000,000 tons of ore you had to produce 3,000,000 tons of the character of ore that your stockholders desired—roughly speaking, Bessemer and non-Bessemer, 3,000,000 tons a year is all that we planned to produce.

We did not actually produce 3,000,000 tons a year, but that
146 was the plan. Otherwise there would not be any need for that investment in stripping. I think we could have produced 3,000,000 tons in 1913, but I am not sure whether we could have made the grade or not, because our stripping program was not completed at that time. I do not think it was actually completed until 1914, as I remember it.

The actual production in 1914 was 1,212,000 tons. We have that discrepancy between actual production and this plan, because, if you will put your memory back to 1914, it was a pretty poor year in the iron and steel business and in business generally.

The next year there was a considerable demand for iron ore. You see we had reached 2,300,000, but we were still 700,000 short of 3,000,000 because the stockholders did not want it. I can not explain why they never did want it until 1923, because I did not know their business. I mean, here were a group of men—six of them—all administering or most of them as presidents of various steel companies, with all of the ramifications that they involve. Now, they gathered together and they said, "We want this many tons out of there." I have seen them change their minds two or three times in six months, but it would be pure supposition on my part to try

to say what factors determined them in setting that tonnage. Of course, you have always to remember that in this situation here you had a lot of stockholders who wanted to agree—I mean, one fellow, if he found that the majority wanted a certain thing, if he possibly could he would agree with them, and then he would go out and arrange his own affairs accordingly.

147 As to making any estimate of the probable life of this mine as a whole, you can divide tonnage by any production that you like, and, of course, you get all kinds of lives to it, and then you can take this affidavit, which is as near as I ever came to it. When you commence to talk about these forties out to the west of there, in section 18 over in Itasca County, there is no basis whatever to go on. This affidavit is the first real attempt that I ever made at determining the life. We did make an estimate of the glacial drift on top of the ore in tracts 3 and 4. I did exactly as you indicated. We went and observed around the periphery of these properties, and arrived at what the over-burden was. We took drill holes such as we had, and found out what there was in those, and on that basis we made an estimate. We did make an estimate of the ore body itself in that affidavit. I think you will find that estimate, if my recollection is correct, is the same as the Minnesota Tax Commission used.

In my reports to stockholders, I did not find it necessary to estimate the future life of the property. You see when you are dealing with such a large ore body as that, if you predicate your operating conditions for ten or twelve years ahead, that is as far as you need to go. There is no use of your going further, because you get into the realm of uncertainty, where you accomplish nothing. Coming back to that blueprint there, there are some of these drill holes that do not go to the bottom of the ore body at all. I remember one that went down for about 75 feet, and then it stopped at a given level.

148 I found it necessary to forecast into the future for 10 or 12 years operation. We had to make sure we had ore enough uncovered of a proper grade, and all that kind of thing, to cover the period such as we could prepare for. In the conduct of the appropriation, it was necessary that I should make my estimates on from 10 to 12 years in the future.

We would not have the same uncertain factors confronting us in estimating 12 years into the future that we would if we tried to go further into the future, because in the 10 or 12 years that you are dealing with—you are not trying to delimit, to set the final limits of your tonnage. For instance, in that property, you sometimes work five or six or seven or eight years, and you only lower yourselves 25 feet, or maybe, at the most, 50 feet in that length of time; so there is a difference there between the estimate that an operator might make for the purpose of laying out his operations and an estimate that an individual is setting of the total tonnage in the property.

"Q. Well, I will ask you other questions. You did consider it practical and feasible to attempt to forecast the future requirements of the ore for 10 or 12 years, did you?—A. Yes.

"Q. Could you have gone as far as 15 years?—A. I suppose you might; yes.

"Q. Well, what about 20 years?—A. Yes; I think you could have done that.

"Q. What about 25 years?—A. Well, I don't know.

"Q. You begin to get doubtful at 25 years?—A. I do.

149 "Q. So that, somewhere between 20 and 25 years, you think it is impractical to attempt to estimate the future requirements in ore?—A. Wait a minute, Mr. Mitchell. You are trying to lead me into something, and I am trying to tell you my story here the best way I can. Now, you asked me—you say, could you do it for 15 years; could you do it for 20 years? Think of the things that are involved in that. How do I know that this mine will not be producing 4,000,000 tons 15 years from now? It all depends upon the assumptions that I make.

"Q. Well, is it not necessary——A. The facts are—well, all right; you go ahead.

"Q. Is it not necessary in the conduct of this business to make assumptions based on your very best judgment?—A. Yes; it is."

Upon redirect examination J. C. AGNEW further testified:

Referring to my affidavit dated May 8, 1921 (Exhibit C), tracts 1, 2, 3, and 4 mentioned therein did not contain all of the ore properties of this company as of 1916. There were about 10 forty-acre tracts that were not contained in tracts 1, 2, 3, and 4. There had not been any exploration on those tracts to any appreciable extent. I don't think you could say there was none. I think there were a few tests, but nothing that you could call exploration. They were mineral lands, so acquired and so held by the company. As far as I know, nobody in 1916 or up to to-day had any definite idea of the

150 extent of ore under those properties that are not so included in this affidavit.

Referring again to the same affidavit, and referring now in the same connection to Exhibit B as to tract No. 1, I am to be understood as having said that all of these forties had been thoroughly explored except the two extreme ones and a little bit of one of the others. Tract 2 is very well explored, I would say. Tract 1 is where the main operating property is located. As to tracts 3 and 4, the estimates contained in my affidavit are based on all the data that we could accumulate from adjoining properties, plus whatever information we could gain from the drilling. I think, as I recollect it, about two or three years after the tax commission took and changed the valuation of that property. We drilled a couple of those forties, about five holes to the forty, the idea being that we felt it would be unwise to continue to pay on such tonnage unless we could reason-

ably assume it was there. These 28 holes, coupled with the information that could be obtained from the outside, led us to believe that that estimate could not be lowered, and therefore we quit. I do not think we drilled all of those forties. That is my recollection. My recollection further is that there were some exploring operations carried on with respect to tracts 3 and 4 after 1916 and before this estimate in the affidavit of 1921. I am quite sure that the estimate of content as to tracts 3 and 4 is exactly the same as the Minnesota Tax Commission figures. That is where I think I got them
151 originally. That is, the Tax Commission of Minnesota assigned a tonnage to each one of those forties. Of course, we carried that along on our records, where they reported it to us every day, and we did this little drilling to find whether it was possible to refute any of these estimates, and we found it was not. We stopped drilling, and I think those are the figures we used. I am pretty certain of it. In speaking of refuting those estimates, I mean by that whether they were too high.

"Q. Now, referring to a part of this affidavit, respondent's Exhibit C, which you have read from, and concerning which Mr. Mitchell asked you some questions, from the information at hand as of March 1, 1913, you would estimate that tract No. 1 only could produce 2,300,000 tons for a period of 25 years, and so forth, that estimate having to do with the production. State whether or not that was made from an operating standpoint.—A. Well, yes; it was made—I was certain that it was possible for the property to do at least that, if I make myself clear, and I was not making a statement there that, in my judgment and to my knowledge of the property, it could not be performed.

"Q. Now, in answer to one or two of Mr. Mitchell's recent questions as to the necessity of making estimates for a period of 10 or 12 years—I believe that is the expression used—state whether those estimates were made from an operating standpoint.—A. They were.

"Mr. MITCHELL. Would you mind defining that a little bit more?

152 "Mr. FORD. The capacity of the mine rather than outside business conditions and all the other various elements.

"Mr. MITCHELL. I see."

In making these 10-year and 12-year estimates and in what I said in my affidavit I took into consideration other factors besides mine capacity. I had to take into account two things. One was the varying requirements of these stockholders, who might come and call on this property for a very large tonnage of ore, and occasionally as they did come in, in the middle of the summer, and change their minds and want the production stepped up. Then I also had to take into account changes in their requirements as to grades of ore, which would involve mixing, and accessibility to the different parts of the mine, where the different qualities of ore occurred. It was my duty as manager of that mine always to be ready for whatever they would ask for.

Upon recross-examination, J. C. AGNEW testified as follows:

In making my estimates, as set out in my affidavit, that the mine could produce 2,300,000 tons a year, I was not referring solely to the capacity of our mine when I made that statement. This statement was made up for depletion purposes, and I know there was considerable discussion of this proposition, as to how this depletion would be handled, what the tonnage would be, and all that kind of
153 thing, and my recollection of it is that this 2,300,000 tons was arrived at in that way, taking into account what other people might want us to do and what the mine could do and weighing all the various factors.

It was not my best estimate of the probable future production. It is one estimate of the life of this mine, of the annual production of this mine. I have made estimates, as I told you, on various bases, that I must be prepared to meet various demands for tonnage of the mine; the mine must always be prepared to do that. If that had been an estimate of the ultimate annual capacity of the mine, I expect I probably would have put down five or six million instead of 2,300,000, but I would not put it down for that length of time. If anybody had asked me what that mine could produce as of 1914, I could have said five or six million tons a year.

"Q. There is just one thing I want to get straightened out on. I understood you to say, referring to those eight forty-acre pieces that are in a row, that the middle six of those were susceptible of a reasonably accurate estimate of the ore content, and that the two end quarters were not. Did I understand you correctly?—A. Yes.

"Q. Now, I want to call your attention to your testimony given in the hearing of the appeal of Julia Andrews Bruce.

"Mr. TOMPKINS. What page?

"By Mr. MITCHELL:

"Q. On page 28 of that record, the last five lines of that
154 page, and I ask you if you did not say that there was one forty which lies east of the six middle forties on which a reasonable estimate could be made?—A. That is in the record there, and if it is there, I probably said it.

"Mr. FORD. Read after that, Mr. Mitchell.

"Mr. MITCHELL. He is reading here——

"Mr. FORD. Well, let him read the testimony.

"Mr. MITCHELL. Suppose you read your answer.

"The WITNESS (reading):

"'Why, I would say that as to approximately the actual operating area for this purpose we will call six forties, or 240 acres that was developed. There was one forty which lies east of the one there; I think a reasonable estimate could be made—forty to the west, would be more in doubt. There was an additional 60-acre tract which lay not far from the present operation, where a reasonably accurate estimate could be obtained, but the rest of the property would be a matter of just judging.'

"By Mr. MITCHELL:

"Q. So, on your former testimony, you said, in effect, did you not, that the——A. If that is in the record, I said it.

"Q. (continuing.) That the east forty in the row of the eight forties was susceptible of a reasonable estimate of ore tonnage?—A. If that is in the record, I said it."

155 The foregoing was all of the evidence introduced on behalf of petitioner in this cause.

Respondent, thereupon, introduced certain evidence as follows:

E. J. STACK having first been duly sworn as a witness on behalf of respondent, on direct examination testified as follows:

My name is E. J. Stack. I am a mining engineer, and I am employed by the Government as a valuation mining engineer. Including the time at college I have been a mining engineer about twenty years. I valued properties on the Mesaba Range and other properties in the Lake Superior district ever since I have been with the Government. In fact, I have not done anything else but appraise properties in the Lake Superior district since 1922. I have traveled over the district, but once or twice I examined the different properties. I have examined and reported on ore mines owned and operated by Butler Brothers, Marquette Iron Company, the Hull Rust, and Mahoning properties, and some other smaller ones, which I have forgotten. I personally examined the properties of the Mahoning Ore & Steel Company in 1925.

"Q. Did you have any part in arriving at the commissioner's ore estimate of approximately 83,000,000 tons and a life of 45 years, as of March 11, 1916?—A. Well, I examined it, and I think in the spring of 1925 I made an appraisal. The ore estimate used in my

156 appraisal was identical with the one used in the present valuation. The life of the mine used in my appraisal was 42 years.

* * * * * * *

In finding the ore tonnage and the probable life of a mine, such as the Mahoning mine, we estimate the ore reserves, and in computing the ore reserves we get all available data, such as drill records, underground development work, shafts, prospects, and so forth, and surface indications, together with any information that might be obtained from operations on the adjoining properties. We quite often refer to estimates by the State of Minnesota as a check against the estimates used in the unit to verify our estimates. The investigations conducted by the State of Minnesota are considered among mining men very reliable as to the tonnages and the estimates of the ore reserves, but I do not know about their estimates as to the life of mines. I have no information about their estimates of probable life or their values. The Mahoning mine is one of the leading and largest iron-ore properties; that is, combined with the Hull Rust mine it is one of the largest producers of iron ore in the country. That combined property comprises one big pit, about two miles long

and three-quarters of a mile wide. I do not know of any active ore property in the world larger than that in 1916. There were some inactive, undeveloped ore regions. I would say that in 1916 it was the largest developed iron mine in the United States.

The iron-ore formation on the Mesaba Range is a well-de-
157 fined formation. At this particular occasion they have a well-defined foot wall, regular, uniform foot wall, outcropping just north of the Mahoning tract No. 1, inclined at an angle of about 11 or 12 degrees, reaching a depth on the south side of this tract 1 of about a hundred feet; and underneath there is a sedimentary formation. Above this foot wall is the iron ore of very good grade; in fact, one of the best grades of iron ore in the United States, about 60 per cent iron and very low in phosphorus. Above the iron ore is the surface of overburden of glacial drift varying from 5 to 20 or 30 feet thick.

The method of mining typical in that neighborhood is strip mining. Drag lines and every form of steam shovel are used in removing that overburden. That is hauled away from the property, and the ore removed by the steam shovels.

It is feasible to estimate the ore content. You can make a very accurate estimate of it. I would say the degree of accuracy obtained in estimating ore reserves in this property would be much higher than at any other mine that I know of, because of the geological conditions and the development of the drill work, and the activity of adjacent properties. It is much easier to make a more accurate estimate of the Mahoning reserves than it is of others, because of mining conditions, the geological formation and the types and quality and character of the ore. Compared with the estimates of ore reserves in nonferrous metal mines, such as are found in Montana and Idaho—the estimate on the Mesaba Range was considerably more accurate. There
158 is really no comparison. I do not know of any mining section on which it is easier to estimate the ore reserve than it is on the Mesaba.

I am familiar with the book, "Report of the Minnesota Tax Commission, 1914," and particularly the sections of that book dealing with Minnesota iron ore properties. The sections of that book dealing with Minnesota iron ore properties are regarded as authoritative scientific utterances.

Thereupon, attorney for respondent read from page 79 of said report the following:

"It was apparent to the commission that with the unusual character of the Mesaba ore deposits, being contained in detached rock basin of greater or less extent and covered by a glacial drift overburden of a few feet to not over 200 feet, it was only a matter of sufficient churn and diamond drilling, test pitting, and other exploration and development work, and a plotting of the result for each five feet of drilling, to calculate the quantity and grade of each layer of iron ore, and to obtain the total tonnage and its general average grade."

He further read from page 82 of said report the following:

"Minnesota is especially fortunate in having its mineral wealth deposited in such form that it can be accurately measured and
159 valued, and is probably the only State that has carefully measured the known iron-ore deposits, and is assessing such wealth on a strictly legal basis."

(The witness then continued his testimony as follows:)

Except for the very last statement dealing with the method of assessing this wealth, I agree with the statements just read. I have no information one way or the other as to how Minnesota assesses this wealth, whether it is fairly done or otherwise. I think that the commissioner's estimate of a probable life of 45 years for this mine is a very accurate estimate as of March 11, 1916. As to the factors that enter into such an estimate, in underground mines, the physical capacity is quite important; but if it is a large open pit, it is not. There are other elements more important—economic conditions, especially in the steel industry, and the number of properties operated by the company operating this particular mine also has a very important bearing, together with the terms of the leases as compared with other leases, and the local conditions of this mine; that is, it may be to the operating company's advantage to curtail operations at one mine and increase them at another. I have knowledge of several sales of iron-ore properties since March 1, 1913. The Meyers mine on the Mesaba Range was sold in 1917. The Kosmerl mine on the Mesaba was sold January 1, 1913. The Kosmerl mine was sold to the United States Steel Company. The owners received
160 promissory notes payable over a term of years, about 30 or 40 years. I do not remember whether there was any cash involved or not. Those notes were for fixed amounts, independent of the time. The total sale price was computed by estimating the ore reserves, multiplying that by the royalty rate, which was 25 cents, I think, or 40 cents—there were about 10,000,000 tons—and making the total sales price of about $4,000,000, to be received over a period of 40 years, in equal annual payments. The total sales price was based upon the estimates of ore content and probable life. That case was involved in a proceeding before this board. The name of the appeal was the Ruth Iron Mining Company. The Donora mine on the Mesaba was sold in April, 1913, on the same basis and the same terms as the Kosmerl sale; i. e., promissory notes, based on estimates of probable life and royalty rate existing under the lease. Higgins No. 1 and No. 2 were sold in 1917. The consideration for that sale was similar to the others. That was paid for again in promissory notes. Other sales were the Ray Prospect, Gilbert in 1917, and the Midway in 1913. I don't recollect just exactly how the consideration was arrived at for the first property. The sales price was arrived at in the same way, but I think the majority of these sales were based on ore estimates at the date of sale. I do not know

of any iron properties sold where the sale price was fixed on any other basis than estimates of ore content and probable life. I regard the Kosmerl transaction as a typical transaction. Another
161 mine that I did not mention is the Tener, which was sold in 1922. That is on the Mesaba Range also.

Upon cross-examination said E. J. STACK further testified:

I did not say that the first trip I ever made out to this Mahoning property was in 1925. I said I examined the property at that time. I have been over the adjoining properties; 1925 was the only time I have been on that property.

I had no part in fixing the valuation that the Commissioner of Internal Revenue arrived at in this particular case. I do not know whether there was any one year down to 1926 in which the Mahoning mine produced exactly 1,841,300 tons. The production varies very greatly from year to year. The annual production over the period from 1913 to 1926 fluctuated from year to year. When the commissioner estimated in this case that the life of this mine would be 45 years, that was based on the assumption that the mine would produce an average annual production of 1,841,000 tons.

"Q. If the annual production, in fact, was not 1,841,000 tons, then the assumption as to a 45-year life would be changed, would it not?—A. Not necessarily.

"Q. Not necessarily?—A. No, sir.

"Mr. MITCHELL. You are speaking of the average production or the average annual production?

"Mr. TOMPKINS. I am speaking of the fact that if the mine
162 produced, we will say, 500,000 tons or more annually each year you would have to assume a different life than 45 years from March 11, 1916.

"The WITNESS. If the average annual production was any other than 1,841,000 tons, it would change the life, certainly.

"By Mr. TOMPKINS:

"Q. As a matter of fact, did the commissioner, in deciding these cases, have any expert make a personal examination of this Mahoning property, or did he not rely upon the figures which he had obtained from the Mahoning Company and which had been used for purposes of fixing the depletion rate for that company?—A. That valuation was made before my time in the unit.

"Q. You do not know anything about that?—A. No.

"Q. Don't you know that since this case was decided by the Commissioner of Internal Revenue the commissioner has fixed, in a depletion proceeding, a different life, a different annual production for this Mahoning mine than that upon which he decided this case?—A. As of the same basic date?

"Q. Yes.—A. He did not; not to my knowledge.

"Q. Not to your knowledge?—A. No.

"Q. That appears in the stipulation. You referred here, Mr. Stack, to a number of sales of different ore properties made during

the period from 1913 to 1917. As I understand it, in all those
163 properties, the prices which the purchasers were to pay for the properties was fixed, only the price was not paid in cash; it was paid by a series of promissory notes, each for a fixed amount, and extending over a period which you say was estimated to be the life of the mine. Is that true?—A. Well, the sales price was arrived at by taking into consideration the estimated tonnage, the operating life, and royalty rate. Now, whether those promissory notes extended over the same period, I could not say."

I did not play any part in the negotiations leading up to those sales; I know nothing of them of my own knowledge. In most of them the sale price was fixed and definite and paid for by promissory notes.

"Q. Do you know of any case in which stock in an ore company such as this—and I call your particular attention to the fact that I used the word 'stock,' not sale of ore property, but stock—was sold under a contract, in which the total amount which the sellers would receive under the contract was not fixed but indefinite?—A. I do not recall any right now.

* * * * * * *

"Q. Did you know, Mr. Stack, that of the mineral lands of the Mahoning Ore & Steel Company, there were somewhere between three and four hundred acres that had not been valued at all?—A. Three or four hundred acres of undeveloped land.

"Q. I beg your pardon?—A. Undeveloped land. We valued mineral land only.

"Q. You did not value that land?—A. No.

164 "Q. I see. Let me ask you another question, and then I will be through. When you said you valued—what kind of land only?—A. Mineral.

"Q. That is, you mean by that as to which complete exploration has been made?—A. Land which was known to contain minerals.

"Q. Do you want to take the position that three or four hundred acres were known not to contain minerals?—A. No; I am not taking that position.

"Q. Well, I just want to make it clear. By the term that you have used, by calling the other mineral land, I thought you meant to indicate this was not mineral land.—A. They were not referred to us for appraisals, because it was not known that they contained mineral as of that date.

"Q. In other words, whether or not they contained minerals, you do not know; is that correct?—A. I do not."

The three or four hundred acres that I have referred to were on the Mesaba Range. I think a few of those 40-acre tracts were near the edge of the Mesaba Range, and some of them were toward the center.

"Q. I say, it has been testified to here that this Mahoning property, the property which is leased to the Mahoning Company, con-

sisted of approximately slightly over a thousand acres of mineral land. You do not dispute that acreage, do you?—A. Not the acreage; no.

"Q. Not the acreage; it has also been stipulated in this case that the commissioner, in arriving at his estimate as to the life of the mine and as to the ore reserves, based that estimate
165 upon the content of recoverable ore in only approximately 620 acres out of the entire property leased by the company, and therefore that there must be four hundred and some acres in the property which had not been explored or taken into consideration in arriving at this estimate; is that true?—A. They were not included in that valuation."

Upon redirect examination E. J. STACK further testified:

The land on which the Government found mineral content is shown on Exhibit B. The Government did not find a mineral content for the remaining land which seems to be indicated on Exhibit A because it has no record of any mineral on those tracts. The commissioner has no information whatever that they contained any mineral. They are unproven as far as mineral content is concerned.

"Q. There has been some reference here to two appraisals by the commissioner. Are you familiar with the stipulation of facts which sets out those two appraisals?—A. Yes.

"Q. It is true, is it not, that one of those appraisals was as of March 1, 1913, and the other one was as of March 11, 1916?—A. Yes, sir.

"Q. The commissioner, as of March 1, 1913, estimated the probable life as 40 years and as of March 11, 1916, as 45 years. Are those appraisals consistent or inconsistent?—A. I consider those two appraisals very consistent.

"Q. Why do you say that?—A. Because they are made on
166 different basic dates, as of different basic dates. In each case you had a different set of facts on which to base the valuation."

In the later appraisal you had additional history of three years to consider. The production for those three years was slightly less than 2,000,000 tons a year, and during those three years the demand for iron ore was about the average.

Upon recross-examination said E. J. STACK further testified:

I say the production of this mine for three years preceding 1916 was slightly under 2,000,000 tons a year. The production for 1913 was about 1,500,000 tons. For the year 1914 it was about 1,212,287 tons. For the year 1915 the stipulation in evidence shows that it was 2,311,940 tons.

H. L. PARRISH, having been first duly sworn as a witness on behalf of respondent, upon direct examination testified as follows:

My full name is H. L. Parrish. My occupation is a valuation engineer in the Bureau of Internal Revenue. I am a mining engineer and have been in the mining business, including the years in school and working, from 1910. I have been on the ore property mined by the Mahoning Ore & Steel Company a good many times. In 1923 I worked on it and am familiar with the property. I am also familiar in a general way with the Mesaba Range, particularly with that part of it around Hibbing, and also some of the portions lying fur-
167 ther east and further west. My work in 1923 was largely in the examination of and surveying of the open pit around the mines in various parts of the Mesaba Range. I know that the ore content of every mine on the Mesaba Range that I had any connection with had been very fully estimated. I am not so certain as to what the probable life of any particular property may have been. That would depend upon the program of the operator. It is practicable for one conversant with all the facts to make an estimate of probable life.

Upon cross-examination said H. L. PARRISH further testified:

"Q. These estimated ore reserves of properties on the Mesaba Range you have testified to have been estimated for the purpose of fixing depletion rates for those companies up there as required by law; is not that true?—A. Not always so; no, sir.

"Q. Not always so?—A. What estimates are you referring to?

"Q. You have testified here, in answer to Mr. Mitchell, that the ore reserves of most of those properties on the Mesaba Range have been estimated and valued. Did you not testify to that?—A. I testified that they could be estimated and that they had been estimated; yes, sir.

"Q. And that they had been. As a matter of fact, all of them had been estimated for the purpose of fixing depletion rates for different companies; is not that true?—A. That is probably true, but I did not have that in mind in my answer.

168 "Q. And in order to fix those depletion rates you have to make some estimate of the ore reserves; is not that true?—A. That is true; yes."

The foregoing testimony of E. J. Stack and H. L. Parrish was all the testimony introduced on behalf of respondent in this cause.

True and correct copies of all of the exhibits referred to in the testimony and proceedings, except such as are fully set forth herein, are transmitted herewith and made a part of the statement of evidence, as if fully set forth herein.

Thereupon counsel for petitioner and counsel for respondent stated that they had no further evidence to present and submitted the case to the member of the United States Board of Tax Appeals hearing the proceeding.

The petitioner, Julia Andrews Bruce, tenders and presents the foregoing as a statement of the evidence in this case and prays that the same be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

GEO. O. MAY,
CHARLES D. HAMEL,
R. B. GOODELL,
JOHN ENRIETTE,
Attorneys for Petitioner,
906 Southern Building, Washington, D. C.

Approved and agreed to.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

169 Before United States Board of Tax Appeals

[Title omitted.]

Order approving statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth and contains all of the evidence in said case in narrative form, the exceptions taken to rulings, and the proceedings had upon the trial of said cause. Where the testimony here is set forth in the form of questions and answers, it is so set forth that the evidence might be clearly understood.

It further appearing to the board that it is proper and necessary that certain exhibits, referred to in the statement of evidence and incorporated therein by reference, should be inspected by the United States Circuit Court of Appeals, it is hereby ordered that true and correct copies of said exhibits be transmitted by the clerk to said court in connection with the statement of evidence and transcript, as follows:

(1) Respondent's Exhibit A—Map showing location of Mahoning property.

170 (2) Respondent's Exhibit B—Map prepared from descriptions of Minnesota authorities.

(3) Respondent's Exhibit D—Map of tracts 1, 2, 3, and 4.

Said statement of evidence on the petition for review of Julia Andrews Bruce is hereby approved and signed and ordered to be made of record in the above-entitled cause, this 30th day of September, 1929.

(s) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

Now, October 3, 1929, the foregoing statement of evidence and exhibits certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

171 Before United States Board of Tax Appeals

[Title omitted.]

Præcipe for transcript of record

Filed Sept. 27, 1929

To the Clerk of the United States Board of Tax Appeals:

You will please prepare a transcript of record in this cause and on or before October 15, 1929, transmit the same to the clerk of the United States Circuit Court of Appeals for the Second Circuit, and include in said transcript, copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the board in the above-entitled cause.
2. Petition for redetermination.
3. Respondent's answer.
4. Findings of fact and opinions of the board, promulgated June 14, 1928.

172 5. Order of redetermination, entered June 15, 1928.

6. Petition for review by the United States Circuit Court of Appeals for the Second Circuit, filed December 13, 1928.
7. Statement of evidence.
8. This præcipe for transcript.

In addition to the foregoing documents, please transmit in connection with the transcript of record, certified copies of orders enlarging the time for the transmission and delivery of documents in accordance with the rules of the United States Circuit Court of Appeals, which orders are dated, respectively, February 13, 1929, March 20, 1929, May 31, 1929, June 24, 1929, August 1, 1929, August 30, 1929, and September 16, 1929.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

Charles D. Hamel,
John Enriette,
Attorneys for Petitioner.

C. M. Charest,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

Now, October 3, 1929, the foregoing præcipe certified from the record as a true copy.

[seal.]

B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

173 In United States Circuit Court of Appeals, Second Circuit

JULIA ANDREWS BRUCE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Order substituting party respondent

Nov. 26, 1929

Upon the annexed stipulation, it is

Ordered that this cause be, and it hereby is, revived in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and he hereby is substituted in this cause for the former Commissioner of Internal Revenue, David H. Blair.

WM. PARKIN, *Clerk.*

174 In United States Circuit Court of Appeals for the Second Circuit

[Title omitted.]

Stipulation re substitution

It is hereby stipulated and agreed by and between the petitioner in the above-entitled cause and Robert H. Lucas, as Commissioner of Internal Revenue, through their respective attorneys, as follows:

That since the filing of the petition for review in the above-entitled cause David H. Blair, who was at that time Commissioner of Internal Revenue and who was the respondent at that time in the above-entitled cause and had been Commissioner of Internal Revenue since the appeal was originally filed in the United States Board of Tax Appeals at Washington, D. C., has resigned as said Commissioner of Internal Revenue, and his resignation has been duly accepted;

That David H. Blair ceased to be Commissioner of Internal Revenue on the 31st day of May, 1929;

That Robert H. Lucas was duly appointed as Commissioner of Internal Revenue to succeed the said David H. Blair, and has duly qualified as said Commissioner of Internal Revenue;

That on June 1, 1929, said Robert H. Lucas became Commissioner of Internal Revenue, and ever since that time has been, and now is, Commissioner of Internal Revenue.

It is further stipulated and agreed between the petitioner in the above-entitled cause and Robert H. Lucas as Commissioner of Internal Revenue, through their respective attorneys, that agreeably to this court, and in accordance with the law, this cause may be revived so that this action will be pending against the said Robert H. Lucas, as Commissioner of Internal Revenue, and that said Robert H. Lucas,

as Commissioner of Internal Revenue, may be substituted
175 as the respondent in this cause for the said David H. Blair, formerly Commissioner of Internal Revenue;

That there is substantial need for so continuing and maintaining this cause, because if it is not so continued and maintained the order of the United States Board of Tax Appeals, for the review of which the petition for review in this cause was filed, will become final; the tax found by the said Board of Tax Appeals to be due will be assessed and collected from this petitioner without recourse to further contest its legality, or obtain a refund thereof.

It is further stipulated and agreed by and between the petitioner in the above-entitled cause and Robert H. Lucas, as Commissioner of Internal Revenue, through their attorneys, that the service of notice of the motion to revive this action in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and to have his name substitutee as respondent in this causem is hereby waived; and the said Robert H. Lucas, as Commissioner of Internal Revenue, by and through his attorney, consents that an order may be made forthwith by the court reviving this cause in the name of Robert H. Lucas, as Commissioner of Internal Revenue, and substituting him as respondent in this cause for the former Commissioner of Internal Revenue, David H. Blair.

R. B. GOODELL,
Attorney for Petitioner.
C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent, Robert H. Lucas,
as Commissioner of Internal Revenue.

176 In United States Circuit Court of Appeals for the Second Circuit

No. 216—October term, 1929

Argued April 16, 1930. Decided May 19, 1930

Appeal from the United States Board of Tax Appeals

Before MANTON, SWAN, and AUGUSTUS N. HAND, Circuit Judges

JULIA ANDREWS BRUCE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Opinion

Petition to review an order of the United States Board of Tax Appeals which affirmed the respondent's determination of defi-

ciencies in income taxes for the calendar years 1918 and 1919. The taxpayer appeals. Order reversed.

Raymond B. Goodell, of New York City, for petitioner.

G. A. Youngquist, Asst. Atty. Gen., and J. Louis Monarch and John Vaughan Groner, Sp. Assts. to Atty. Gen. (C. M. Charest, Gen. Counsel, Bureau of Internal Revenue, and Allin H. Pierce, Sp. Atty., Bureau of Internal Revenue, both of Washington, D. C., of counsel), for respondent.

MANTON, *Circuit Judge.*

This petitioner owned 350 shares of stock of the Andrews & Hitchcock Iron Company, which she owned prior to March 1, 1913, and sold on March 11, 1916, under the circumstances and terms referred to in the case of Logan v. Commissioner (C. C. A.) 41 F. (2d) —, decided this day. She also inherited 550/4000 interest from her mother's estate. The income in question was moneys received during two years, 1918 and 1919, as payment made pursuant to the contract obligation of the Youngstown Sheet & Tube Company to this petitioner. The same contract is involved. For the reasons there stated, it follows that the order of the board determining these moneys in part to be income and taxable was erroneous, and the order must be reversed.

Order reversed.

177 In United States Circuit Court of Appeals, Second Circuit

JULIA ANDREWS BRUCE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed May 26, 1930

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed.

It is further ordered that a mandate issue to the said board in accordance with this decree.

WM. PARKIN, *Clerk.*

178 [File indorsement omitted]

179 [Clerk's certificate to foregoing transcript omitted in printing.]

180 In the Supreme Court of the United States

Order extending time within which to apply for writs of certiorari

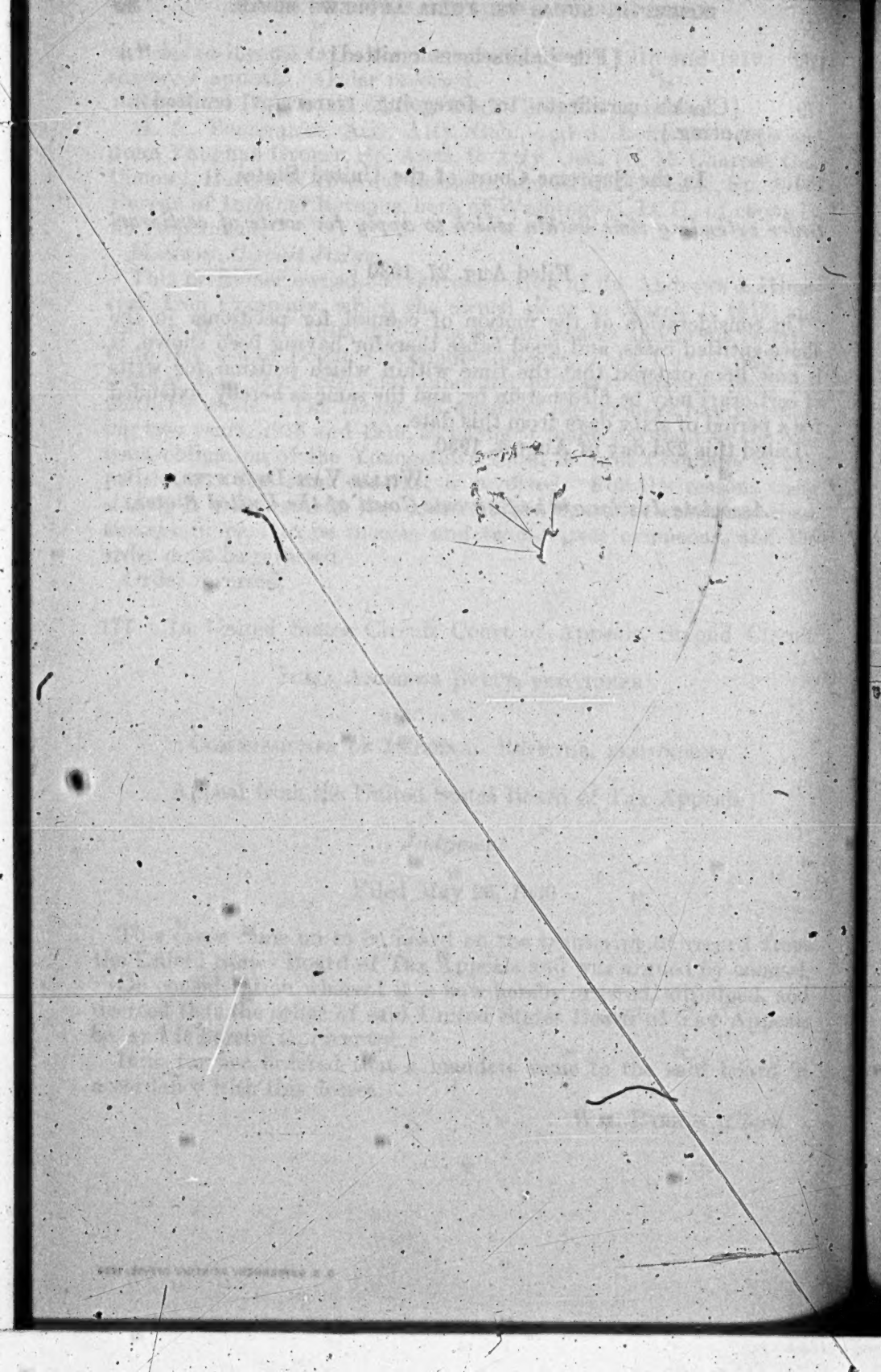
Filed Aug. 27, 1930

On consideration of the motion of counsel for petitioner in the above-entitled cases, and good cause therefor having been shown, it is now here ordered that the time within which petition for writs of certiorari may be filed herein be, and the same is hereby, extended for a period of sixty days from this date.

Dated this 22d day of August, 1930.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

U. S. GOVERNMENT PRINTING OFFICE: 1930



Supreme Court of the United States

Order allowing certiorari—

Filed December 1, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

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CHARLES ELMORE CROP
Cl

Nos. 521-522

In the Supreme Court of the United States

OCTOBER TERM, 1930

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDITH ANDREWS LOGAN

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIA ANDREWS BRUCE

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1930

No. ———

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDITH ANDREWS LOGAN

No. ———

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIA ANDREWS BRUCE

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the

Second Circuit entered in the above-entitled cases on May 26, 1930, reversing the decision of the United States Board of Tax Appeals.

STATEMENT

These cases involve deficiencies in income taxes determined against the respondents for the calendar years 1918, 1919, 1920. (R. 69.)[1] The facts in the cases are practically identical.

Prior to March 1, 1913, and until March 11, 1916, the respondents owned certain shares of the stock of the Andrews & Hitchcock Iron Company, which company held a 12% stock interest in the Mahoning Ore & Steel Company. The latter company controlled, by a lease for a long term of years, an iron-ore mine. The Mahoning Company was an operating company, and, pursuant to contract provisions, distributed the ore which it mined only to its stockholders, who were steel manufacturers. (R. 30–31, 103–107.)

On March 11, 1916, the Youngstown Sheet & Tube Company purchased all the outstanding capital stock of the Andrews & Hitchcock Company, thus acquiring the 12% stock interest in the Mahoning Company and the right to a percentage of the ore mined by it. The Youngstown Company paid $2,200,000 in cash for the Andrews & Hitchcock stock, and in addition contracted to pay the former stockholders of the latter company sixty cents per

[1] All references herein are to the record in the case of Edith Andrews Logan unless otherwise indicated.

ton for each and every ton of iron ore which the Youngstown Company might thereafter become entitled to receive from the Mahoning Company. Payments were to be made annually under the contract and the stock in the Mahoning Company was to be deposited as collateral security. (R. 97–103.) Respondents thus acquired rights to payments under this contract in proportion to their holdings in the stock of the Andrews & Hitchcock Company. Mrs. Logan acquired a 250/4,000 interest and Mrs. Bruce acquired a 350/4,000 interest. (R. 99.)

In 1917 the mother of the two respondents died, and each acquired by bequest an additional 550/4,000 interest in the contract. (R. 37, 92.)

The fair market value of the Youngstown contract, at the date of its receipt, was found by the Commissioner to be $1,942,111.46. For lack of evidence to the contrary this value was approved by the Board. (R. 57.) The value of the 550/4,000 interest which each acquired by bequest was fixed at $277,164.50 for purposes of Federal estate tax at the time of the mother's death. (R. 37.)

During the years here involved the Youngstown Company made payments in accordance with the terms of the contract, and respondents respectively received sums proportionate to the interests which they acquired by exchange of property and by bequest. (R. 35–37.)

The Board held that respondents' receipts from the contract, during the years in question, represented " gross income "; that respondents should

be allowed to deduct from said gross income a reasonable allowance for exhaustion of their contract interests; and that the balance of the receipts should be regarded as taxable income. (R. 57, 58–59.)

The Circuit Court of Appeals reversed the Board's decision. It held that no part of the receipts constituted taxable income; and that no income would be received until respondents had first recovered:

> (1) As regards their interests in the contract acquired by exchange of property, the March 1, 1913, value of the property exchanged, and
>
> (2) As regards their inherited interests the value of those interests at the time of their mother's death.

Four other stockholders of the Andrews & Hitchcock Iron Company appealed from the same decision of the Board of Tax Appeals which the Court reviewed in this case. Their cases were taken to the Circuit Court of Appeals for the Sixth Circuit on a consolidated record entitled *Frank Hitchcock* v. *Commissioner of Internal Revenue*, No. 5550. That case was argued orally on April 17, 1930, but no decision has been rendered. By reason of that fact application was made for an extension of the period within which petition for certiorari could be filed. An order extending the time for a period

of sixty days from the date of the order was signed by Mr. Justice Van Devanter on August 22, 1930.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the contract right to receive annual payments in the future had no fair market value, and that the sale of stock by which the contract was acquired was therefore not a closed transaction.

2. In holding that the contract did not have a fair market value of $1,942,111.46 on March 11, 1916, as determined by the Commissioner and approved by the Board of Tax Appeals.

3. In holding that the difference between the $2,200,000 in cash and the March 1, 1913, value of the stock must be returned through the payments under the contract before there could be any income from the contract right acquired through the sale of stock.

4. In failing to recognize that the interest acquired in the contract through inheritance presented a question not controlled by the determination that the interest acquired through sale of stock had no fair market value, and in applying the same reasoning to both interests. There is no finding that the inherited interest was not capable of being capitalized anew. On the contrary, the opinion below recognizes that it had a capital value.

5. In holding that the payments received by respondents under their contract rights were not taxable in any part as income during the years 1918, 1919, and 1920.

REASONS FOR GRANTING THE WRITS

In so far as the respondents' interests were inherited, the decision of the Circuit Court of Appeals is in conflict with that of the Circuit Court of Appeals for the Sixth Circuit in *Eldredge* v. *United States,* 31 F. (2d) 924, where it was held that payments made to one of the owners of a contract which produced a return on each ton of coal mined by a corporation from a certain mine represented part income and part return of capital.

With respect to the interests in the contract acquired both by purchase and by inheritance, the identical questions here involved are now pending before the Circuit Court of Appeals for the Sixth Circuit in cases brought by other stockholders of the Andrews & Hitchcock Iron Company to review the same decision of the Board of Tax Appeals which is involved in the instant cases. If that court follows its earlier decision in the *Eldredge case, supra,* a direct conflict between the Circuit Court of Appeals for the Second Circuit and the Circuit Court of Appeals for the Sixth Circuit will be presented on both questions.

The question of when income is derived from annual payments under a contract such as here in-

volved is one of present importance in the administration of the Revenue Acts. Under the decisions rendered herein the first annual payments from the contract would be regarded as a return of capital and no taxable income would be derived for many years. After the capital has all been recovered it would seem that the payments in the future years would all be income. Thus under the decisions below no tax may be imposed upon the payments in the earlier years, but the burden of the tax will be heavy in the later years when the payments will be treated as all income. Accordingly, the principles of tax law involved in these cases are of general public importance, from the standpoint of both the Government and the taxpayers.

These principles would doubtless be applicable to the owners of all royalty contracts. Moreover, as pointed out by the Board of Tax Appeals in *Florence L. Klein* v. *Commissioner*, 6 B. T. A. 617, 622, the theory of apportionment which has been disapproved below is applicable to partial sales of single plots of real estate and to those who retail goods purchased in bulk.

Wherefore, it is respectfully submitted that this petition for writs of certiorari to review the judgments of the Circuit Court of Appeals for the Second Circuit should be granted.

THOMAS D. THACHER,
Solicitor General.

OCTOBER, 1930.

18799—30——2

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals in the *Logan case* is reported in 42 F. (2d) 193, and the opinion in the *Bruce case* is reported in 42 F. (2d) 197. The findings of fact and the opinion of the Board of Tax Appeals (R. 27–68) are reported in 12 B. T. A. 586.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered May 26, 1930. On August 22, 1930, the time for filing this petition was extended to October 21, 1930. Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondents acquired certain interests in a contract by virtue of which they received annually certain payments measured by the number of tons of iron ore delivered from a certain mine. The question presented is whether the payments received under the contract are to be regarded in the earlier years as entirely a tax-free recovery of capital, as held by the Circuit Court of Appeals, or whether each payment is to be regarded as partly a return of capital and partly the receipt of income.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1062, 1064, 1065, 1066:

SEC. 210. * * * There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.

SEC. 211. (a) * * * in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

* * * * *

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

* * * * *

Regulations 45 (1920 edition) relative to the Revenue Act of 1918, provided:

Art. 201. Depletion of mines, oil and gas wells; depreciation of improvements.

* * * * *

When used in these articles of the regulations covering depletion and depreciation—

* * * * *

(*b*) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase. Where there has been no sale and the fair market value at the basic date is to be used, such value will be determined by the method which a prospective vendor and vendee in the industry would use in arriving at the sale value of the property at the basic date.

STATEMENT

The facts are stated in the petition for certiorari.

ARGUMENT

The interests acquired by each respondent by inheritance from their mother was valued for inheritance tax purposes at $277,164.50. (R. 37, 92.)

The considerations which led the Circuit Court of Appeals to hold that the interests acquired by the sale of the respondents' stock could not be recapitalized by the Commissioner had no application to the inherited interests. In so far as the inherited interests are concerned the question is squarely presented whether the annual payments include income in any part. In holding that these payments consisted wholly of capital returns the court below has taken a position directly in conflict with that of the Circuit Court of Appeals for the Sixth Circuit in *Eldredge* v. *Commissioner*, 31 F. (2d) 924. In that case the taxpayer owned a contract which produced a payment of two and one-half cents on each ton of coal mined by a corporation from a certain coal mine, and the court was called upon to decide what portion of said payments represented taxable income. The decision states in part as follows (p. 928):

> It does not, however, follow, as appellants contend, that nothing is taxable until appellants have received payments to an aggregate amount exceeding the 1913 capital value. The statement that a taxpayer is entitled to return of capital means nothing more than that, by the time he has received all the money coming to him in a transaction, he must have been allowed to deduct his full capital; it does not necessarily mean that no tax is to be imposed until the entire capital shall have been received.

The same principle was recognized in *Rosenberger* v. *McCaughn* (C. C. A. 3rd), 25 F. (2d) 699, certiorari denied, 278 U. S. 604. In that case an owner of land demised to a coal company all coal under the land with the right to mine it for a term of 99 years in consideration of monthly rents reckoned on the coal raised and the price realized. The court there said (p. 701):

> Reverting to the plaintiff's contention that all payments she had received under the instrument here in question were tax free because they were part payments of the purchase price of property sold prior to March 1, 1913, still—always keeping in view the nature of mining, the source of the proceeds—we think each payment represented in some measure both capital and increment, capital because it stood in the place of coal and increment because in the payments running through ninety-nine years' interest on the capital must inevitably have been included, and that this increment or interest was a gain "derived" within the generalization of the statute "from any source whatever" and was income in substantially the sense of *New Creek Co.* v. *Lederer* (C. C. A.) 295 F. 433.

The reasonableness of this plan is evident, for it places the respondents' income from the mine on the same general plan as is used in computing the income of the ore-producing company itself. As the Mahoning Mine is developed the Mahoning Ore

& Steel Company reports its gross income and receives a deduction for depletion proportionate to the decrease in value of its leasehold interest. While in the instant cases the Commissioner divided the royalties received as between a return of capital and income, the result reached is the same as if the entire royalties received had been included in gross income and an allowance for exhaustion of the contract treated as a deduction from this gross income. Thus the analogy between "depletion" and "exhaustion" pointed out by this Court in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, is observed and the principle of gradual capital recovery, explained by this Court in *United States* v. *Ludey*, 274 U. S. 295, is recognized.

Under the plan approved by the Circuit Court of Appeals no such equitable result would be obtained. The first annual payments from the contract would be regarded as all capital and the Government's right to taxation of income would be long deferred.

That even where the payments clearly represent deferred installments of the purchase price there is an element of income present, if the period of payment is extended over a term of years, has been recognized by the courts in several decisions. See *Ruth Iron Co.* v. *Commissioner of Internal Revenue* (C. C. A. 8th), 26 F. (2d) 30; *Kosmerl* v. *Commissioner of Internal Revenue* (C. C. A. 7th), 25 F. (2d) 87; *Rosenberger* v. *McCaughn, supra; Platt* v. *Bowers*

(S. D. N. Y.), 13 F. (2d) 951. The reason therefor is apparent when it is considered that an obligation for a sum total of deferred payments over an extended period must be discounted as to present worth and as payments are made they indisputably contain other elements than capital return.

The plan of capital recovery approved by the court in this case might result in no taxable income ever being derived from the Youngstown contract. The plant necessarily postpones the receipt of "income" until all "capital" has been recovered. If respondents should die prior to the time when the capital has been entirely recovered their right to future income would be recapitalized for their heirs, just as was done upon the death of the respondents' mother, and the receipt of income would be still further postponed. Thus it is possible that respondents' interests in the Youngstown contract might pass by inheritance from one person to another, and that no tax on the annual payments would ever become payable.

With respect to the interests which were acquired by the sale of stock the Board of Tax Appeals held that the stockholders of the Andrews & Hitchcock Company had in 1916 exchanged their capital stock for an income-producing contract having a "fair market value"; that the exchange was, for tax purposes, a closed transaction; and that all future receipts from the contract, less a reasonable allowance for exhaustion of the contract, were taxable in-

come. The court below held that the contract had no "fair market value" in 1916; hence, that there was no closed transaction; and that respondents were entitled to recover the March 1, 1913, value of the stock which they had exchanged.

In *Chicago Ry. Equipment Co.* v. *Blair* (C. C. A. 7th), 20 F. (2d) 10, the court recognized fair market value to be the price which one under no compulsion is willing to take for property which he has for sale, and which another, under no compulsion, being desirous and able to buy, is willing to pay for the article. The court said (p. 14):

> It is not necessary that a property shall be for sale before it can have a market value. Neither is it necessary that there shall be a known buyer for it.

Respondents' witnesses did not state that the contract could not be sold or that it had no realizable value. Their testimony was merely that they knew of no sales by which the fair market value could be determined, no "general market" for contracts of that character, and no "established or current market price" (R. 131, 132). Witness J. B. Putnam, when asked why he believed that the "real value" could not be realized in cash, testified that the elements which determined value were not definitely fixed. (R. 132.) It is evident that the meaning of the witness was not that the contract was not salable, but rather that its value was subject to uncertainties. Such evidence might tend

to show a low market value but it is not sufficient to overcome the Board's finding that there was a "fair market value."

The stockholders of the Andrews & Hitchcock Company were assured payments of 60¢ per ton on 12% of the total ore reserves of the Mahoning Ore Company and the payments were guaranteed by collateral security. The Mahoning Mine, on the production of which the payments were to be measured, was one of the leading and largest iron ore properties in the country. (R. 172.) The ore content of the mine could be accurately estimated. (R. 173.) The rate of production could be calculated with reasonable certainty from twenty-six years of actual production history. (R. 159, 96.) It can not be doubted that this contract, which was yielding its owners large sums annually, had intrinsic value as well as a market value. The "fair" market value was largely a matter of calculation.

The fair market value of the contract actually was determined in 1917 when respondents' mother died, and that value was used for Federal estate tax purposes. No reason appears why the fair market value was not determinable also in 1916.

The Commissioner of Internal Revenue found that the contract had a fair market value in 1916 of $1,942,111.46 and his determination was approved by the Board of Tax Appeals. (R. 57.) The respondents offered no evidence to show error

on the part of the petitioner in making such determination. The petitioner's determination was prima facie correct and in the absence of contrary evidence it should have been accepted. *Bishoff* v. *Commissioner of Internal Revenue* (C. C. A. 3d), 27 F. (2d) 91, 93.

CONCLUSION

In view of the need of a definite rule for the guidance of the courts and the Treasury Department, it is respectfully submitted that the petition for writs of certiorari should be granted.

THOMAS D. THACHER,
Solicitor General.

G. A. YOUNGQUIST,
Assistant Attorney General.

J. LOUIS MONARCH,
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Special Assistants to the Attorney General.

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ALLIN H. PIERCE,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

OCTOBER, 1930.

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Nos. 521 and 522

In the Supreme Court of the United States

OCTOBER TERM, 1930

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDITH ANDREWS LOGAN

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIA ANDREWS BRUCE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE PETITIONER

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 521

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

EDITH ANDREWS LOGAN

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 522

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JULIA ANDREWS BRUCE

MEMORANDUM FOR THE PETITIONER

On pages 4 and 6 of the petition for certiorari reference is made to a group of cases pending before the Circuit Court of Appeals for the Sixth Circuit on a consolidated record entitled *Frank Hitchcock* v. *Commissioner of Internal Revenue,*

which involved certain other stockholders of the same company in which respondents were interested and presented the same questions as the instant cases. Since the filing of the petition for certiorari those cases have been decided, the principal opinion being rendered in *Frank Hitchcock* v. *Commissioner of Internal Revenue*. This opinion is printed as an appendix hereto. As a result of that decision, there is now a direct conflict between the Circuit Courts of Appeals for the Second and Sixth Circuits with respect to interests in the identical contract, acquired in a similar manner. This conflict affords an additional reason for the granting of the petition.

A copy of this memorandum has been served upon counsel for respondents.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.

NOVEMBER, 1930.

APPENDIX

No. 5550

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT

Frank Hitchcock, petitioner, *v.* Commissioner of Internal Revenue, respondent. Petition to Review an Order of the United States Board of Tax Appeals

Decided November 5, 1930

Before MOORMAN, HICKS, and HICKENLOOPER, Circuit Judges.

MOORMAN, Circuit Judge: Prior to March 1, 1913, and continuously until March 11, 1916, petitioner owned 1,000 of the 4,000 shares of the capital stock of the Andrews and Hitchcock Iron Company. During all that time that company owned twelve per cent of the capital stock of the Mahoning Ore & Steel Company, the lessee for 97 years from April 1, 1895, of certain mineral lands in the Mesaba Range of Minnesota. The remaining stock in the Mahoning Company was owned by other steel companies. By contract entered into December 16, 1914, the stockholders of the Mahoning Company agreed that in the future the output of the mines of the company should be sold exclusively to themselves; that the Board of Directors of the company

should fix, on or before April 1st of each year, the amount of ore to be produced from the mines during the year; and that each stockholder should be entitled to take annually its share of the ore produced at a price to be fixed by the Board at or about the cost of production. Later, on March 11, 1916, while this contract was in full force and effect, all of the stockholders of the Andrews & Hitchcock Iron Company, including petitioner, sold their stock in that company to the Youngstown Sheet & Tube Company. The consideration paid by the Youngstown Company was $2,200,000.00 in cash, plus a contract by which it agreed to take annually the full quota of ore to which the Andrews Company might be entitled under the contract of December 16, 1914, and to pay to each of the selling stockholders his proportion of sixty cents a ton for each ton of ore which it so took. All the transferred stock was deposited by the Youngstown Company as security for the carrying out of this contract.

The petitioner received payments on the contract according to its terms for each of the years 1918, 1919 and 1920. In determining his tax liability for those years the commissioner treated these payments as gross income, allowing certain deductions therefrom to compensate the petitioner for the exhaustion of the contract. This action of the commissioner was premised upon the ground that the 1916 transaction was closed and completed on March 11, 1916, and that the contract with the Youngstown Company was the sole capital base for determining whether the returns therefrom were capital or income. In determining the fair market value of the contract the commissioner estimated

the total ore reserves in the mines to be 82,858,535 tons, the average annual production to be 1,841,300 tons, the life of the mines to be 45 years, and the probable total future receipts from the contract to be $5,965,814.52. Upon these hypotheses he determined the value of the contract according to Hoskold's formula to be $1,942,111.46, and allocated the petitioner's receipts therefrom to the return of capital and to income in the same proportion as the total capital to be recovered bore to the total anticipated receipts. These determinations resulted in the commissioner's making deficiency assessments against petitioner for the years in question. It is from an approval of those assessments by the Board of Tax Appeals that this appeal is prosecuted.

The commissioner did not fix the value of the Andrews Company stock as of March 1, 1913, and there is no finding of fact to the effect that petitioner's total anticipated receipts from the contract, added to his share of the $2,200,000.00, would exceed the value of the stock as of that date. Consequently, if the capital value which petitioner is entitled to have returned is the value of the Andrews Company stock as of March 1, 1913, there is no showing of any tax liability for any of the years here involved. It is the contention of the commissioner, however, that it was not necessary to value the stock as of that date, because that value could only be used as a basis for determining gains or losses on the stock when it was sold on March 11, 1916, which are matters not involved in this proceeding. He admits that the market value of the petitioner's interest in the contract, plus the cash which he received, did not exceed the March 1, 1913,

value of the stock, but contends that that too only concerns the question of gains or losses on the stock. It was his position in making the assessment and is his contention here that the transaction of March 11, 1916, was a completed transaction in which petitioner converted capital consisting of stock into other capital consisting of cash and an income-producing contract, and that the contract thus acquired formed the capital base for determining whether the income which it produced were taxable gains or the return of capital.

By the transaction of March 11, 1916, the petitioner received, as part consideration for his stock, an income-producing contract. That contract, in our opinion, is indistinguishable in its legal aspects from the contract involved in *Eldredge* v. *United States*, 31 Fed. (2d) 924, where the taxpayer assigned an option for a lease in consideration of a promise to pay two and a half cents per ton of coal mined if the assignee elected to take the lease. This court held in that case that the contract right to the two and a half cents a ton of coal mined was capital having an ascertainable market value within the meaning of the taxing statutes, and that the payments made thereon were in part return of capital and part income. We are aware, of course, of the inconsistency between that decision and the decision of the Second Circuit Court of Appeals in *Logan* v. *Commissioner*, 42 Fed. (2d) 193, where it was held that the payments made to certain former stockholders of the Andrews Company on the contract here involved were to be treated as capital payments until the entire capital value (it would seem the March 1, 1913, value of the Andrews Company stock) was paid in full.

The Logan case was decided, as stated by the court, upon the principle announced in the earlier decision of the same court in *Warner* v. *Walsh*, 15 Fed. (2d) 367. We had *Warner* v. *Walsh* under consideration in the *Eldredge case*, and for the reasons given in the opinion in that case did not deem it controlling. Neither do we deem it applicable in this case. Contrarily we think the fairer method of treating the returns from a contract such as this is to apportion them to capital and income in the proportion that the total capital to be recovered bears to the total anticipated receipts. To follow the Logan case in this case would require an abandonment of that view and the overruling of the *Eldredge case*. This we would do if we thought the latter case wrong, but upon a reconsideration of it in the light of the Logan case and of the arguments now made, we still believe that it was rightly decided and in the present circumstances is controlling. Compare *Kosmerl* v. *Commissioner*, 25 Fed. (2d) 87; *Ruth Iron Co.* v. *Commissioner*, 26 Fed. (2d) 30, and *Reinecke* v. *Spalding*, 280 U. S. 227.

From an examination of the evidence introduced before the Board we find no reason for not accepting the findings of the commissioner with respect to the total ore reserves in the mining property, the probable average annual production, the life of the mines and the probable total future receipts from the contract. We also accept the market value of the contract as determined by the commissioner according to Hoskold's formula. *Pfleghar Hardware Co.* v. *Blair*, 30 Fed. (2d) 614; *Eldredge* v. *United States*, *supra*. It is insisted, though, that the proofs show that the contract was not capable of valuation in money because of the

changing conditions in the steel industry, the dependency of the Youngstown Company's obligations upon the policies of the companies owning the controlling stock in the Mahoning mines, and the many uncertainties that arise in the operation of mining properties. Here again the finding of the commissioner is to be treated as prima facie correct (*Wickwire* v. *Reinecke,* 275 U. S. 101; *Austin Co.* v. *Commissioner,* 35 Fed. (2d) 910, 6 C. C. A.), and upon a consideration of the evidence we do not feel justified in overruling it. It was not necessary that the contract should be for sale or that there should be a known buyer for it before it could have a market value. *Chicago Railway Equipment Co.* v. *Blair,* 20 Fed. (2d) 10. It is true that it was held in both *Bourn* v. *McLaughlin,* 19 Fed. (2d) 148, and *Tsivoglou* v. *United States,* 27 Fed. (2d) 564, that certain properties received in exchange for others had no realizable value in money's worth, and hence there was no taxable gain on the exchange. Those cases, however, turn on their special facts, and also deal with values for the purpose of determining losses or gains on the property given in exchange. In this case the value was fixed, not to determine gain or loss on the stock but for the purpose of apportioning the earnings from the contract to capital and gain. The necessity for ascertaining the value of capital consumed in producing income is obvious. It is a necessity that frequently arises and is clearly contemplated in the statutory provisions authorizing allowances for obsolescence, depletion and exhaustion. Revenue Act of 1918, Section 214 (a) (Sections 8 and 10). The best methods that can be used are often lacking in demonstrable exact-

ness. See *United States* v. *Ludey*, 274 U. S. 295. The one used in this instance received the approval of this court in the *Eldredge case*. We think it was fair, and we are also of opinion that the commissioner properly apportioned the receipts from the contract to capital and income in the proportion that the total capital to be recovered bore to the total anticipated receipts.

The order is affirmed.

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Nos. 521, 522

In the Supreme Court of the United States

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDITH ANDREWS LOGAN

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JULIA ANDREWS BRUCE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 521

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

EDITH ANDREWS LOGAN

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JULIA ANDREWS BRUCE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals in No. 522 (R. 87–88) is reported in 42 F. (2d) 197, and the opinion in No. 521 (R. 94–99)

is reported in 42 F. (2d) 193. The findings of fact and the opinion of the Board of Tax Appeals (R. 15–32)[1] are reported in 12 B. T. A. 586.

JURISDICTION

The judgments to be reviewed were entered on May 26, 1930. (No. 521, R. 100–No. 522, R. 88.) On August 27, 1930, the time for filing petitions for certiorari was extended to October 21, 1930. (No. 521, R. 100–No. 522, R. 89.) Petitions for certiorari were filed October 21, 1930, and were granted on December 1, 1930. (No. 521, R. 101–No. 522, R. 91.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondents acquired certain interests in a contract by virtue of which they received annually certain payments measured by the number of tons of iron ore delivered from a certain mine. The question presented is whether the payments received under the contract are to be regarded in the earlier years as entirely a tax-free recovery of capital, as held by the Circuit Court of Appeals, or whether each payment is to be regarded as partly a return of capital and partly the receipt of income.

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[1] Unless otherwise stated, all record references relate to No. 521.

STATUTE AND REGULATIONS INVOLVED

These will be found in Appendix A.

STATEMENT

These cases reached the Circuit Court of Appeals on petitions to review orders of the Board of Tax Appeals (No. 521, R. 35–No. 522, R. 27), determining deficiencies against respondent in No. 521 for the years 1918, 1919, and 1920, and against the respondent in No. 522 for the years 1918 and 1919.

The facts as found by the Board (R. 15–20) are in substance as follows:

Prior to March 1, 1913, and until March 11, 1916, the respondents owned certain shares of the stock of the Andrews & Hitchcock Iron Company, which company held a 12% stock interest in the Mahoning Ore & Steel Company. The latter company controlled, by a lease for a long term of years, an iron-ore mine. (R. 15.) The Mahoning Company was an operating company, and, pursuant to contract provisions, distributed the ore which it mined only to its stockholders, who were steel manufacturers. (R. 16, 49–51.)

On March 11, 1916, the Youngstown Sheet & Tube Company purchased all the outstanding capital stock of the Andrews & Hitchcock Company, thus acquiring the 12% stock interest in the Mahoning Company and the right to a percentage of the ore mined by it. (R. 15.) The Youngstown

Company paid $2,200,000 in cash for the Andrews & Hitchcock stock, and in addition, as the balance of the purchase price, contracted to pay to a depositary for the benefit of the former stockholders of the latter company sixty cents per ton for each and every ton of iron ore which the Youngstown Company might thereafter become entitled to receive from the Mahoning Company. (R. 16.) Payments were to be made annually under the contract and the stock in the Mahoning Company was to be deposited as collateral security. (R. 46–49.) Respondents thus acquired rights to payments under this contract in proportion to their holdings in the stock of the Andrews & Hitchcock Company. Mrs. Logan acquired a 250/4000 interest and Mrs. Bruce acquired a 350/4000 interest. (R. 47.)

In 1917 the mother of the two respondents died, and each acquired by bequest an additional 550/4000 interest in the contract. (R. 18, 44.)

The fair market value of the Youngstown contract on March 11, 1916, was found by the Commissioner to be $1,942,111.46. This was based upon an estimate that the ore reserves at the Mahoning mine amounted to 82,858,535 tons; that all such ore would be mined; that 12 per cent (or 9,942,564.2 tons) would be delivered to the Youngstown Company. (R. 20.) The total amount to be received by all the vendors of stock would

then be $5,965,814.52 at the rate of 60 cents per ton. The Commissioner's figure for the fair market value on March 11, 1916, was the then worth of $5,965,814.52, upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6 per cent, with a provision for a sinking fund at 4 per cent. For lack of evidence to the contrary this value was approved by the Board. (R. 28.) The value of the 550/4000 interest which each acquired by bequest was fixed at $277,164.50 for purposes of Federal estate tax at the time of the mother's death. (R. 18.)

During the years here involved the Youngstown Company made payments in accordance with the terms of the contract, and respondents respectively received sums proportionate to the interests in the contract which they acquired by exchange of property and by bequest. (R. 17–18.)

The Board held that respondents' receipts from the contract, during the years in question, represented "gross income"; that respondents should be allowed to deduct from said gross income a reasonable allowance for exhaustion of their contract interests; and that the balance of the receipts should be regarded as taxable income. (R. 28–29.)

The Circuit Court of Appeals reversed the Board's decision. It held (R. 99) that no part of the receipts during the years in question consti-

tuted taxable income; and that no income would be received until respondents had first recovered—(1) As regards their interests in the contract acquired by exchange of property, the March 1, 1913, value of the property exchanged, and (2) as regards their inherited interests the value of those interests at the time of their mother's death.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the contract right to receive annual payments in the future had no fair market value, and that the sale of stock by which the contract was acquired was therefore not a closed transaction.

2. In holding that the contract did not have a fair market value of $1,942,111.46 on March 11, 1916, as determined by the Commissioner and approved by the Board of Tax Appeals.

3. In holding that the difference between the $2,200,000 in cash and the March 1, 1913, value of the stock must be returned through the payments under the contract before there could be any income from the contract right acquired through the sale of stock.

4. In failing to recognize that the interest acquired in the contract through inheritance presented a question not controlled by the determination that the interest acquired through sale of stock

had no fair market value, and in applying the same reasoning to both interests. There is no finding that the inherited interest was not capable of being capitalized anew. On the contrary, the opinion below recognizes that it had a capital value.

5. In holding that the payments received by respondents under their contract rights were not taxable in any part as income during the years 1918, 1919, and 1920.

SUMMARY OF ARGUMENT

Respondents sold corporate stock, receiving therefor part cash and an interest in a contract providing for a payment of 60 cents on each ton of ore which the purchaser became entitled to take from the Mahoning mine. Respondents later acquired additional interests in the same contract by bequest from their mother.

The Commissioner determined that the contract had a fair market value and accordingly treated the sale of the stock as a closed transaction and valued the contract rights as of the time of their receipt, which he used as the basis for apportioning the annual receipts from the contract between income and capital.

The court below held that the fair market value of the contract had not been established, that the sale of respondents' stock was not a closed transaction, and that no part of the annual receipts from the contract was income, because respondents had

not yet received the March 1, 1913, value of their stock or the value of the inherited interests in the contract at the time of their mother's death.

1. Whether property has a fair market value is a question of fact. The finding of the Board that the contract had fair market value was supported by substantial evidence and should have been accepted by the court below, as it was by the Circuit Court of Appeals for the Sixth Circuit in a group of cases presenting the same question with respect to the same transaction.

2. The annual receipts from the contract were inherently income by nature, and it is not entirely clear that respondents were entitled to any of the statutory allowances for depletion or exhaustion. However, an allowance was made by the Board for the exhaustion of the contract, and for present purposes we merely contend that it is sufficient. The Circuit Court of Appeals for the Sixth Circuit approved the apportionment between income and capital, and its decision is in direct conflict with the decision of the court below. The requirement that capital must all be returned tax free before there is any income is limited to cases of sales, and in several decisions the courts have held that where the period of payment is extended over several years it is more logical to say there is some income involved in each payment.

In so far as the annual payments received by respondents were attributable to the inherited in-

terests, the question is controlled by *Irwin* v. *Gavit*, 268 U. S. 161. The decision of the court below sanctions a rule in conflict with that decision. Moreover, the decision below is not supported by its reasoning, which is solely applicable to the purchased interests in the contract.

ARGUMENT

PRELIMINARY STATEMENT

The property which produced the income in these cases was a contract providing for a payment of 60 cents on each ton of ore which the Youngstown Company became entitled to take from the Mahoning mine. The payments received in the taxable years were segregated by the Commissioner into part income and part return of capital. The Board of Tax Appeals held that the annual receipts should be included in gross income in their entirety but that a deduction should be allowed for the exhaustion of the contract under Section 214 (a) (8) of the Revenue Act of 1918, applying the same method of calculation as is used for determining depletion of mines. Since the net result was the same as the Commissioner's determination (R. 30), the Board sustained the Commissioner.

The Circuit Court of Appeals held, in effect, that the fair market value of respondents' interests in the contract of 1916 had not been established, that this contract did not represent a closed transaction, that the basis for computation was the March

1, 1913, value of the shares owned by the respondents and the value at the time of the mother's death of the inherited interests in the contract, and that no taxable income arose until the whole of those values were returned to respondents.

I

THE FAIR MARKET VALUE AS OF MARCH 11, 1916, OF THE PURCHASED INTERESTS WAS SUFFICIENTLY ESTABLISHED

The Commissioner determined that when the respondents sold their stock in 1916 the value of the interests acquired by them in the contract plus the cash they received was more than the cost but less than the March 1, 1913, value of their stock and that hence the transaction resulted in neither gain nor loss. (R. 57, 95.) The court below held that the contract interests had no ascertainable fair market value when acquired by respondents in 1916 (R. 97) and that therefore the exchange did not constitute a closed transaction. Upon this theory it held that there is no taxable income until there has been a return of the March 1, 1913, value of respondents' stock interests in the Andrews & Hitchcock Company, and of the value as at the mother's death of the inherited interests in the contract. (R. 99.)

The Circuit Court of Appeals for the Sixth Circuit, considering a precisely similar question arising out of the same contract, in *Hitchcock* v. *Com-*

missioner of Internal Revenue, 44 F. (2d) 756, took a contrary view and said (p. 758):

> It is insisted, though, that the proofs show that the contract was not capable of valuation in money because of the changing conditions in the steel industry, the dependency of the Youngstown Company's obligations upon the policies of the companies owning the controlling stock in the Mahoning mines, and the many uncertainties that arise in the operation of mining properties. Here again the finding of the commissioner is to be treated as prima facie correct (*Wickwire* v. *Reinecke,* 275 U. S. 101, 48 S. Ct. 43, 72 L. Ed. 184; *Austin Co.* v. *Commissioner,* 35 F. (2d) 910 (6 C. C. A.)); and upon a consideration of the evidence we do not feel justified in overruling it. It was not necessary that the contract should be for sale or that there should be a known buyer for it before it could have a market value. *Chicago Railway Equipment Co.* v. *Blair* (C. C. A.) 20 F. (2d) 10. It is true that it was held in both *Bourn* v. *McLaughlin* (D. C.) 19 F. (2d) 148, and *Tsivoglou* v. *United States* (D. C.) 27 F. (2d) 564, that certain properties received in exchange for others had no realizable value in money's worth, and hence there was no taxable gain on the exchange. Those cases, however, turned on their special facts, and dealt with values for the purpose of determining losses or gains on the property given in exchange. In this case the value was fixed, not to determine gain or loss on the

stock but to apportion earnings from the contract to capital and gain. The necessity for ascertaining the value of capital consumed in producing income is obvious. It is a necessity that frequently arises and is clearly contemplated in the statutory provisions authorizing allowances for obsolescence, depletion, and exhaustion. Revenue Act 1918, § 214 (a) (8) and (10), 40 Stat. 1067. The best methods that can be used are often lacking in demonstrable exactness. See *United States* v. *Ludey,* 274 U. S. 295, 47 S. Ct. 608, 71 L. Ed. 1054. The one used in this instance received the approval of this court in the *Eldredge Case.* We think it was fair, and we are also of opinion that the commissioner properly apportioned the receipts between capital and income.

The decision in the *Hitchcock case* is in harmony with the evident purpose of Congress to reach all income (see *Irwin* v. *Gavit,* 268 U. S. 161, 166) and to tax it as soon as received. The shifting of income from one year to another is to be avoided. *Newman* v. *Commissioner of Internal Revenue* (C. C. A. 10th), 41 F. (2d) 743, certiorari denied, 282 U. S. xiii.

The statute provides that when property is received in an exchange it shall be treated as the equivalent of cash to the extent of its fair market value. Section 202 (b) of the Revenue Act of 1918, *infra.* Fair market value may be said to mean the price at which a seller, willing to sell at a fair price, and a buyer, willing to buy at a fair

price, both having reasonable knowledge of the facts, will conclude a bargain. Cf. *Chicago Ry. Equipment Co.* v. *Blair* (C. C. A. 7th), 20 F. (2d) 10, 13.

The question whether property has a fair market value is one of fact to be determined in each case in the light of all the surrounding circumstances. The Board of Tax Appeals found that the contract had a determinable fair market value when received by respondents in 1916, and that there was no evidence showing that the value determined by the Commissioner was erroneous. (R. 24.) This is in accord with the rule that the determination of the Commissioner is *prima facie* correct and that taxpayers have the burden of establishing that it is erroneous. *Reinecke* v. *Spalding,* 280 U. S. 227. Moreover, the Board of Tax Appeals is a fact-finding body and upon review of its decision an appellate court should not reject the Board's findings unless wholly unsupported by the evidence. *Bishoff* v. *Commissioner of Internal Revenue* (C. C. A. 3d), 27 F. (2) 91, 92. The court below recognized this rule (*Bedell* v. *Commissioner of Internal Revenue* (C. C. A. 2d), 30 F. (2d) 622, 625), and it is well settled that appellate review of decisions of the Board extends only to questions of law. This is in accord with the statute, which provides that the courts shall have power to reverse a decision of the Board if it is not in accordance with law. (Section 1003 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.)

We therefore submit that the narrow question of law with respect to whether the contract was the equivalent of cash is: Was there substantial evidence to support the findings of the Board? A review of the evidence shows the following:

The property to be appraised in the cases at bar is the contract providing for net payment of 60 cents on each and every ton of ore which the Youngstown Company may become entitled to take from the Mahoning mine. The obligation to make such payments was absolute and was secured both by the credit of the Youngstown Company and by the 360 shares of stock of the Mahoning Ore and Steel Company. It follows, therefore, that if the tonnage and production of the Mahoning mine can be gauged with reasonable accuracy the determination of value for the contract in question is merely a matter of mathematical calculation.

The Mahoning mine is one of the leading and largest iron ore mines in the United States. (R. 84.) Its location and capacity are described by respondents' witness Agnew. (R. 73, 78.) Estimates of the ore content of the properties had been made by the Minnesota Tax Commission, and after making drillings to test their accuracy the Mahoning Company found the estimates to be conservative. (R. 77.) The report of the Minnesota Tax Commission shows that the ore content of the property could be calculated with unusual accuracy. (R. 85.) The Mahoning Company itself made es-

timates of the ore tonnage in connection with fixing its depletion rates. (R. 75, 82.) The record shows that the Mahoning Company had estimated the average annual production of part of the property for a period of 25 years into the future (R. 75, 81), that the conduct of the mining operation required estimates of from 10 to 12 years ahead, and that it was practicable to forecast the requirements of ore for at least 20 years in advance (R. 80). It was testified that the Commissioner's estimate of a probable life of 45 years was very accurate. (R. 89.)

The determination by the directors of the Mahoning Company of the annual production (R. 16) does not make for uncertainty. It is necessary to the laying of plans for the operating season and is not peculiar to this mine, save in that it also serves to apprise the furnace companies of the quantity of ore that will be shipped to them during the season. The heavy local tax burden (R. 19) will no doubt insure the removal of this high-grade ore (R. 84) as fast as the market will permit.

This property was held for the use and benefit of five steel manufacturing companies (R. 50), and was operated to meet their needs (R. 51). Property of this nature is not held as an investment. It is the source of supply for manufacturing corporations and is ordinarily not for sale. The true value of such a property could only be determined after full development (R. 65), and sales are usually made for only part of the consideration in

cash (R. 65, 66, 67, 86). It is true that there was no regular market for the sale of such contracts (R. 62), but respondents' witnesses did not say that no market could have been found (R. 63). Their testimony was merely that they knew of no sales by which the fair market value could be determined, no general market for contracts of that character, and no established or current market price. (R. 62.)

Respondents' witness Putnam testified (R. 65):

> Now, I do not mean by that that it has no value, and I do not mean by that that you can not arrive at some value for it; but so far as the cash sale value goes, customarily those contracts and interests in iron ore properties are not dealt in in that way.

While the elements which determine the value of this contract were not definitely fixed (R. 64), there is no evidence that the contract was not salable. In view of the inherent value of the property, such evidence, if given, would not have been convincing. While the value of the contract may have been subject to uncertainties, there is no evidence sufficient to overcome the Board's finding. The Board reviewed the evidence carefully and concluded as follows (R. 23–24):

> The contract which the stockholders of the Andrews & Hitchcock Iron Co. had with the Youngstown Sheet & Tube Co. was that they should receive 60 cents per ton upon their

12 per cent interest in the ore mined from the Mahoning mine. The important question in the case is as to whether that contract had a fair market value as of March 11, 1916. The petitioners contend that they could not have gotten a fair market value for their interests in the contract if they had attempted to sell them. Witnesses for the petitioners believed that the true value of the interest of each of the petitioners was much in excess of what each could have sold it for. This question of belief does not, however, in our opinion satisfactorily establish that the interests had no fair market value. In 1916 it could be foreseen that each of the petitioners would receive considerable amounts of money under the contract during the years immediately succeeding 1916. It is hardly probable that persons conversant with the contract would not have given something for the interests of the several petitioners therein. Statements that the contract had no value because in the opinion of certain witnesses the interests of petitioners therein could not have been sold at their full market value is not satisfactory evidence that they did not have a fair market value.

The Committee on Appeals and Review of the Treasury Department reached the same conclusion. (R. 59.)

It was not necessary for the Board of Tax Appeals to discredit the witnesses in order to justify its conclusion that respondents' interests in this

contract had a fair market value. "To say that the testimony is not satisfactory is more polite and less offensive, and at the same time equally sufficient." *Stone* v. *United States,* 164 U. S. 380, 382.

It is true that the court below differed with the Board with respect to the effect of the testimony (R. 97), but we submit that the elements of uncertainty which the Circuit Court of Appeals thought indicated impossibility of valuing the contract easily merely tended to show that its exact value could not be fixed. This did not render it impossible for the Board to put a value upon it, based upon the evidence offered to show its value, nor do the largely imaginary elements of uncertainty, emphasized by the court below, indicate that the determination of the Board was wrong. The holders of this contract were assured of 60 cents per ton upon 12 per cent of the total ore reserves of the Mahoning Company and payments were guaranteed by collateral security. There is no basis in the record for the suggestion of the court below that the contract might be abrogated or changed. Its performance by the Youngstown Company was adequately assured. There was a published production record from the year 1900. (R. 77.) The average production for the three years preceding 1916 was slightly less than 2,000,000 tons. (R. 89.) The production for the year 1915 was 2,311,940 tons. (R. 46.) This production came from only 240 acres out of the total of 1,000 acres leased by the

Mahoning Company. (R. 83.) Judging from the experience of production over this long period, and in the absence of proof of changed conditions which might suggest the probability of a change in rate of production in the future, it was possible to forecast with a fair degree of accuracy the productive life of the mine. The court below emphasized the fact that production was to be determined by the board of directors of the Mahoning Company, but there was no proof to show that they would capriciously order a departure from past rates of production nor that there was any reason for them to do so. The uncertainties were reduced to a minimum and can not reasonably be said to render it impossible to value the contract. We think it is not to be doubted that this contract, which was yielding its owners large sums annually, had market value as well as intrinsic value.

The calculation which would establish "fair" market value could be made as readily by the Commissioner of Internal Revenue as by a prospective purchaser. The fair market value of the contract was in fact determined in 1917 when respondents' mother died, and that value was used for Federal estate-tax purposes. It was equally possible to calculate it in 1916, and the Board's finding that this contract had a fair market value in 1916, based upon substantial evidence, should have been accepted by the court below.

The court below gave no separate consideration to the inherited interests in the contract. The portion of returns from those interests which represented income was taxable in the same way as were the returns from the purchased interests. See *Irwin* v. *Gavit*, 268 U. S. 161. No question of value can well arise with respect to the interests inherited, for their value had to be, and was, determined at the time of the mother's death in 1917.

An allowance was made for the exhaustion of the contract, so that the capital value of the right to receive the income will be ultimately returned tax free, and no double taxation can arise from the fact that the value of this right was included in the gross estate of respondent's mother. Cf. *United States* v. *Supplee-Biddle Co.*, 265 U. S. 189, 196.

It is true that the Circuit Court of Appeals for the Sixth Circuit in the *Hitchcock case* gave no separate consideration to the inherited interests in the contract. In our view there is no difference in principle between the rule to be applied in determining the taxability of income derived from the inherited interests and the purchased interests if the sale of the stock is treated as a closed transaction. The Circuit Court of Appeals for the Sixth Circuit adopted this view, and treating the sale as a closed transaction had no occasion to consider the inherited interests separately. The court below held that the sale was not a closed transaction

and made no distinction in its treatment of interests acquired upon the sale and by inheritance thereafter. If its reasoning could prevail in regard to the sale, such conclusion can have no bearing upon interests subsequently acquired by inheritance.

It is clear that the contract had a fair market value on March 11, 1916, and there was no basis for the lower court's requirement that value on March 1, 1913, should be the measure of capital to be restored.

II

THE ANNUAL RECEIPTS FROM THE CONTRACT CONSTITUTED GROSS INCOME AND A SUFFICIENT ALLOWANCE FOR EXHAUSTION HAS BEEN MADE

There remains to be considered whether the payments received under the contract during the years involved were wholly free from tax. The court below held that no taxable income arose until the full amount of the original values had been returned. The Commissioner apportioned the receipts from the contract between income and capital return. The Board of Tax Appeals held them to be gross income but allowed a deduction for exhaustion of the contract under Section 214 (a) (8) of the Revenue Act of 1918 and applied the depletion method for determining the exhaustion.

It is not entirely clear that any deductions should have been allowed in these cases. It has long been settled that when no sale is involved annual receipts

which represent the earnings of property are taxable in their entirety unless Congress makes an allowance for exhaustion of the property. *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U. S. 126; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103. Whether any annual allowance shall be made is a matter clearly within the province of Congress. *New Creek Co.* v. *Lederer* (C. C. A. 3d), 295 Fed. 433, certiorari denied, 265 U. S. 581; *Kentucky Tobacco Products Co.* v. *Lucas*, 5 F. (2d) 723.

Section 214 (a) (10) of the Revenue Act of 1918, *infra*, makes an allowance for the depletion of mines, and this Court has held that such an allowance may be "made to everyone whose *property right and interest therein* has been depleted." (Italics ours.) *Lynch* v. *Alworth-Stephens Co.*, *supra*, p. 370. It is true that the mine to which the contract here involved related was being depleted by the extraction of the ore, but respondents had no interest in the mine nor such a relation to the mine as would entitle them to the statutory allowance. Cf. *Roxburghe* v. *United States*, 64 C. Cls. 223, certiorari denied, 278 U. S. 598.

Section 214 (a) (8) of the statute makes an allowance for the exhaustion of property used in the trade or business, and the Board of Tax Appeals held that respondents were entitled to an allowance under that section. (R. 28.) Certainly this

was a liberal construction of the statute, for it seems to us that respondents could not fairly be said to be engaged in any trade or business in which their interests in the contract were used.

Section 213 (b) (2) exempts from taxation the amount received by the insured as a return of premiums paid by him under annuity contracts. The essential element of an annuity is the certainty of an amount to be paid periodically at a certain rate per annum or in a certain aggregate annual amount. *Peck* v. *Kinney* (C. C. A. 2nd), 143 Fed. 76, 80. Such certainty is lacking here and thus Section 213 (b) (2) is not applicable. And in no event could that part of the payments attributable to the inherited interests be construed as a return of premiums paid by respondents.[2]

However, a deduction was allowed by the Commissioner and the Board of Tax Appeals in these cases and for present purposes we merely contend that it is sufficient and that respondents have no right to demand that it be increased to such an extent as to render all payments to them under this contract tax free for an indefinite number of years when that would introduce a necessarily artificial interpretation of the nature of the payments.

Since the total amount to be received from the Youngstown Company by all the vendors of stock was $5,965,814.52 (according to the Commission-

[2] For a discussion of the taxability of annuities see Sol. Op. 160, III-2 C. B. 60.

er's computation), while the present worth on March 11, 1916 (the total amount of capital to be restored for all vendors, a proportion of which only having to be restored for each respondent) was but $1,942,111.46, each cash payment to each of the respondents would necessarily be approximately 1/45 of her proportionate interest in $5,965,814.52. Each payment would, therefore, include some profit on her share of the original capitalization of this contract.

It can not be said that the first annual payments under the contract here involved were different in character from the payments to be made in later years. Nevertheless, under the decision below, it is necessary to treat the payments in the earlier years as wholly a return of capital and the payments in the later years as wholly income. This incongruous result is not required by any established principle and seems a wholly arbitrary classification. The principle of capital recovery approved by the court in these cases might result in no taxable income ever being derived from the contract. The decision necessarily postpones the receipt of income until later years and if respondents should die in the meantime the rights under the contract would be recapitalized for their heirs, just as was done on the death of respondents' mother. (R. 18.) Thus the receipt of taxable income from this property would be still further postponed. Accordingly, it is possible that re-

spondents' interests in the contract might pass by inheritance from one person to another and that no tax on the annual payments would ever become due.

On the question of whether payments on the contract are to be regarded as subject to apportionment between capital and income, the decision of the court below is in direct conflict with that of the Circuit Court of Appeals for the Sixth Circuit in *Hitchcock* v. *Commissioner*, 44 F. (2d) 756.[3] In affirming the decision of the Board in the *Hitchcock case* the Circuit Court of Appeals for the Sixth Circuit said (pp. 757–758):

> "By the transaction of March 11, 1916, the petitioner received, as part consideration for his stock, an income-producing contract. That contract, in our opinion, is indistinguishable in its legal aspects from the con-

[3] The *Hitchcock case* was one of a group of four cases involving stockholders of the Andrews & Hitchcock Company other than respondents. These cases were all heard together in the Board of Tax Appeals (R. 13), and included the *Appeal of Carrie L. Shaw, Executrix of the estate of John Shaw, deceased*. The findings of the Board show that John Shaw acquired an interest in the contract involved in these cases by way of gift. (R. 17.) The cases of all four stockholders were heard on a consolidated record in the *Hitchcock case* and the decision of the Board of Tax Appeals was affirmed in the *Shaw case* on the authority of the *Hitchcock case*. A copy of the unreported order in the *Shaw case* is attached to this brief as Appendix B. Thus, it appears that the question as presented to each of the Circuit Courts of Appeals was based on interests in the contract acquired both by purchase and by inheritance or gift.

tract involved in *Eldredge* v. *United States* (C. C. A.), 31 F. (2d) 924, where the taxpayer assigned an option for a lease in consideration of a promise to pay two and a half cents per ton of coal mined if the assignee elected to take the lease. This court held in that case that the contract right to the two and a half cents a ton of coal mined was property having an ascertainable market value within the meaning of the taxing statutes, and that the payments made thereon were in part return of capital and part income. We are aware, of course, of the inconsistency between that decision and the decision of the Second Circuit Court of Appeals in *Logan* v. *Commissioner,* 42 F. (2d) 193, where it was held that the payments made to certain former stockholders of the Andrews Company on the contract here involved were to be treated as capital payments until the entire capital value (it would seem the March 1, 1913, value of the Andrews Company stock) was paid in full. The *Logan Case* was decided, as stated by the court, upon the principle announced in the earlier decision of the same court in *Warner* v. *Walsh,* 15 F. (2d) 367. We had *Warner* v. *Walsh* under consideration in the *Eldredge Case,* and for the reasons given in the opinion in that case did not deem it controlling. Neither do we deem it applicable in the present case, for we think the fairer method of treating returns from a contract such as this is to apportion them to capital

> and income in the proportion that the total capital to be recovered bears to the total anticipated receipts. To follow the *Logan Case* in this case would require an abandonment of that view and the overruling of the *Eldredge Case*. This we would do if we thought the latter case wrong, but upon a reconsideration of it in the light of the arguments now made, we still believe that it was rightly decided and in the present circumstances is controlling. Compare *Kosmerl* v. *Commissioner* (C. C. A.) 25 F. (2d) 87; *Ruth Iron Co.* v. *Commissioner* (C. C. A.) 26 F. (2d) 30, and *Reinecke* v. *Spalding*, 280 U. S. 227, 50 S. Ct. 96, 74 L. Ed. 385.

In the case of *Eldredge* v. *United States* (C. C. A. 6th), 31 F. (2d) 924, relied on as an authority in the *Hitchcock case*, the taxpayer owned a contract which produced a payment of two and one-half cents on each ton of coal mined by the corporation and the court was called upon to decide what portion of the payments represented taxable income. The court said (p. 928):

> It does not, however, follow, as appellants contend, that nothing is taxable until appellants have received payments to an aggregate amount exceeding the 1913 capital value. The statement that a taxpayer is entitled to return of capital means nothing more than that, by the time he has received all the money coming to him in a transaction, he must have been allowed to deduct his full capital; it does not necessarily mean that no

> tax is to be imposed until the entire capital shall have been received.

The words quoted were written by the same judge who wrote the earlier opinion in *Warner* v. *Walsh* (C. C. A. 2d), 15 F. (2d) 367, relied by the court below in the instant cases. With reference to the decision in *Warner* v. *Walsh*, he explained that the decision reflected the then prevailing departmental practice which was merely accepted without argument. After a careful examination of applicable decisions, the court concluded as follows in the *Eldredge case* (p. 929):

> In our judgment, the rule properly applicable in the circumstances of the instant case is that income tax is due upon so much of each annual payment as represents approximately a proportionate amount of the profit on the whole transaction, looked at from the standpoint of March 1, 1913. The first payments are clearly not wholly a return of cost. While for practical reasons, it may be desirable so to deal with them if there be a very high degree of uncertainty as to what, if any minimum profit will result from the transaction, as in most cases of liquidating dividends, this is not true in respect to the case.

Warner v. *Walsh, supra,* as well as *United States* v. *Bolster* (C. C. A. 1st), 26 F. (2d) 760, and *Allen* v. *Brandeis* (C. C. A. 8th), 29 F. (2d) 363, all of which were relied on by the court below, have been recently examined by the New York Court of Appeals, which expressly refused to follow them.

People v. *Lynch*, not yet reported, but may be found in United States Daily, January 12, 1931, page 9. The New York law involved in that case was identical with the Federal revenue law. In that case the court said:

> That the income from this trust estate is not exempt as a gift or bequest, see *Irwin* v. *Gavit*, 268 U. S. 161, which strongly indicates that income remains income, under the Federal income tax act, until it clearly appears to be a return of a capital payment, or the payment of a bequest in installments. The same thought follows in *Jones* v. *Commrs. of Inland Revenue* (1 K. B. Div. (1920) page 711).

In *Florence L. Klein* v. *Commissioner*, 6 B. T. A. 617, the Board of Tax Appeals expressly rejected that part of *Warner* v. *Walsh* which dealt with the manner in which deductions were to be made, and held that so much of the first and each succeeding installment as represents the cost or the March 1, 1913, value is to be treated as a return of capital tax free and the remainder is to be treated as taxable income. In its opinion the Board said (p. 622):

> The statutes provide neither that the first payments are all income nor that they are all return of cost; but they indicate rather that each payment is partly one and partly the other, and that the income part is all that is to be included in gross income. This is consistent with the normal theory of pur-

> chased annuities, and seems to us to be fairer than to regard the first payments as wholly tax free and the latter payments as wholly taxable. The theory of apportionment is applicable to periodic payments just as it is to the ascertainment of gain in the sale of lots in a subdivided tract of land, of retail goods purchased in bulk, and other situations under the statute.

That even where the payments clearly represent deferred installments of the purchase price there is an element of income present if the period of payment is extended over a term of years, has been recognized in several decisions. See *Ruth Iron Co.* v. *Commissioner of Internal Revenue* (C. C. A. 8th), 26 F. (2d) 30; *Kosmerl* v. *Commissioner of Internal Revenue* (C. C. A. 7th), 25 F. (2d) 87; *Platt* v. *Bowers* (S. D. N. Y.), 13 F. (2d) 951.

In *Rosenberger* v. *McCaughn* (C. C. A. 3d), 25 F. (2d) 699, certiorari denied, 278 U. S. 604, an owner of land demised to a coal company all coal under the land with the right to mine it for a term of 99 years, in consideration of monthly rents reckoned on the coal raised and the price realized. In holding that it was proper to allocate part of the annual payments to income, the court said (p. 701):

> Reverting to the plaintiff's contention that all payments she had received under the instrument here in question were tax free because they were part payments of the pur-

> chase price of property sold prior to March 1, 1913, still—always keeping in view the nature of mining, the source of the proceeds—we think each payment represented in some measure both capital and increment, capital because it stood in the place of coal and increment because in the payments running through ninety-nine years interest on the capital must inevitably have been included, and that this increment or interest was a gain "derived" within the generalization of the statute "from any source whatever" and was income in substantially the sense of *New Creek Co.* v. *Lederer* (C. C. A.), 295 F. 433.

The requirement that capital must all be returned tax free before there is any taxable income is limited to cases of sales, as in *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179. The rule that annual receipts which represent the earnings of property are wholly taxable except in so far as Congress grants allowances has already been stated.

This fundamental difference in the treatment of the proceeds of sales of capital assets and the annual receipts from the operation of a business is due to the fact that Congress may tax only the profit on sales of capital assets, whereas in the case of annual receipts, which are inherently income by nature, it is competent for Congress to treat them as wholly taxable. Because property often increases in value even where its physical life is theoretically wasting away, there can be no cer-

tainty that any of the capital value has disappeared until a final disposition of the property is made. Accordingly, this Court sustained an arbitrary depletion allowance in the case of operating mines against the contention that it was wholly inadequate and that consequently the tax was upon property because of its ownership. *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103.

In the brief in opposition (pp. 4–5) respondents cite *Nichols* v. *United States*, 64 C. Cls. 241, certiorari denied, 277 U. S. 584, as presenting practically the same question as the instant cases. The question in that case was whether the distributive share of a partner received by his estate after his death and upon which an estate tax had been paid was also income to the estate upon which an income tax, too, should be paid. The Government contended that it was inherently income, would have been taxable to the decedent if he had received it during his lifetime, and that consequently it should be regarded as income to the estate. The Court of Claims held that when the distributive share was paid to the estate it was corpus and not income, and, having been taxed as part of the estate, could not be again taxed as income to the estate. It is evident that this does not touch the problem here. The Government does not claim a right to tax the capital of the respondents nor, so far as the interests acquired by the respondents by bequest are concerned, does it propose to tax the estate from

which such interests came as if such interests were income to the estate. The Government merely asserts the right to tax such portion of the sums received by the respondents due to the Youngstown Company's performance of its contract, as represents profit or increment and to tax it as that profit or increment is received and not at some indefinite future date.

CONCLUSION

In view of the foregoing it is respectfully submitted that the judgments of the Circuit Court of Appeals should be reversed.

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APRIL, 1931.

APPENDIX A

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1062, 1064, 1065, 1066, 1067:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; * * *.
>
> (b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.
>
> SEC. 210. * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.
>
> SEC. 211. (a) * * * in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.
>
> SEC. 212. (a) That in the case of an individual the term "net income" means the

gross income as defined in section 213, less the deductions allowed by section 214.

* * * * *

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

* * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar condition in each case, based upon cost including cost of development not otherwise deducted: * * *.

Regulations 45 (1920 ed. as amended by T. D. 3206) relative to the Revenue Act of 1918:

ART 201. *Depletion of mines, oil and gas wells; depreciation of improvements.*—Sections 214 (a) (10) and 234 (a) (9) provide that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. * * *

The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) his capital invested in the property or (b) the value of his property on the basic date, plus subsequent allowable capital additions * * *.

* * * * *

When used in these articles of the regulations covering depletion and depreciation—

(a) The term "basic date" indicates the date of valuation, i. e., March 1, 1913, in the case of property acquired prior thereto, the date of acquisition in the case of property acquired on or after March 1, 1913, or the date of discovery, or within 30 days thereafter, in the case of discovery.

(b) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase. Where there has been no sale and the fair market value at the basic date is to be used, such value will be determined by the method which a prospective vendor and vendee in the industry would use in arriving

at the sale value of the property at the basic date.

* * * * *

ART. 206. *Determination of fair market value of mineral property.*—(a) Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will lend due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purpose of the capital-stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods such as the present value method and other factors.

(b) To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The factors are (1) the total quantity

of mineral in terms of the principal or customary unit (or units) paid for in the product marketed, (2) the average quality or grade of the mineral reserves, (3) the expected percentage of extraction or recovery in each process or operation necessary for the preparation of the crude mineral for market, (4) the probable operating life of the deposit in years, (5) the unit operating cost, i. e., cost of production exclusive of depreciation and depletion, (6) expected average selling price per unit during the operating life, and (7) the rate of profit commensurate with the risk for the particular deposit. When the deposit has been sufficiently developed these factors may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the mineral, percentage of recovery, costs of production, and selling price of the product marketed during the expected operating life of the mineral deposit.

* * * * * *

ART. 210. *Computation of deduction for depletion of mineral deposits.*—(a) Depletion attaches to the annual production "according to the peculiar conditions of each case" * * *.

(b) When the value of the property at the basic date has been determined, depletion for the taxable year shall be determined by dividing the value remaining for depletion by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold within the taxable year. In the selection of a unit for

depletion preference shall be given to the principal or customary unit or units paid for in the product sold.

ART. 1564. *Determination of gain or loss from exchange of property.*—(a) The amount of income derived from an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the property received in exchange over the original cost of the property exchanged for it. If the property exchanged was acquired prior to March 1, 1913, and its fair market value on that date was greater than the cost, the income which is taxable is the excess of the fair market value at the time of exchange of the property received in exchange over the fair market value on March 1, 1913, of the property exchanged. No gain is recognized if the fair market value of the property received in exchange is more than the cost of the property exchanged but less than its fair market value as of March 1, 1913. The amount of income derived from a subsequent sale for cash of property received in exchange for other property on or after March 1, 1913, is the excess of the amount so received over the fair market value of the property acquired at the date of the acquisition. * * *

APPENDIX B

Nos. 5552–3–4

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT

CARRIE L. SHAW, EXECUTRIX, ETC.

v.

COMMISSIONER OF INTERNAL REVENUE

ORDER

Before MOORMAN, HICKS, and HICKENLOOPER, Circuit Judges

The orders of the Board of Tax Appeals in these cases are affirmed on authority of *Frank Hitchcock* v. *Commissioner of Internal Revenue,* No. 5550, this day decided.

U. S. GOVERNMENT PRINTING OFFICE: 1931

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Supreme Court, U. S.
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Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 521

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
v.
EDITH ANDREWS LOGAN, RESPONDENT.

No. 522

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
v.
JULIA ANDREWS BRUCE, RESPONDENT.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

R. S. DOYLE,
Attorney for Respondents.

MILLARD F. TOMPKINS,
WALTER M. ANDERSON,
R. B. GOODELL,
JOHN ENRIETTO,
Of Counsel.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 521.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

EDITH ANDREWS LOGAN, *Respondent*.

No. 522.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

JULIA ANDREWS BRUCE, *Respondent*.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

Since the same questions are involved in both cases and since the one petition filed covered both cases, a single brief in opposition is submitted, to be considered as the brief in opposition in each case.

I. *Statement of Questions.*

In considering the petition for a writ of certiorari in this case, the question litigated below should be stated simply and free from the trammels of mathematical formulae, theoretical assumptions, recapitalizations and other elements that obscure reasoning processes.

There are two situations involved. The first is a sale of

250 shares of stock of the Andrews & Hitchcock Iron Company for a pro-rata portion or 250/4000ths of two things: (1) a cash payment of $2,200,000 and (2) a promise to pay 60 cents for each ton of ore which the purchaser of the stock would become entitled to receive thereafter, as and when mined and actually delivered.

On this branch of the case the Court below unanimously held that the respondent who sold her stock, and who made her return for income tax purposes on a cash basis, did not realize any profit taxable as income until her share of the cash down payment added to the total of the subsequent payments actually made under the contract, exceeded the March 1, 1913, value of the shares sold, the statutory basis of computing gain on the sale. There is manifestly nothing new or novel in this holding by the Circuit Court of Appeals for the Second Circuit, so well expressed in Mr. Judge Manton's opinion below. It is in strict accord with the principles governing the determination of gain or loss for income tax purposes on sales of stock and capital assets, frequently expressed by this Court in *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 62 L. Ed. 1054; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 65 L. Ed. 751; *Goodrich* v. *Edwards*, 255 U. S. 527, 65 L. Ed. 758; and kindred cases. No question of paramount or general importance is presented which requires this Court to review its well settled opinions on this branch of the law, which must now be regarded as elementary in the interpretation of our Federal income taxing statutes enacted since the adoption of the Sixteenth Amendment to the Constitution.

The second situation involves the inheritance in 1917 by Respondent from her mother of an interest in this same promise to pay in the future to the extent of 550/4000ths of the total. For the purpose of imposing the Federal estate tax this interest was valued by the Government at $277,164.50. The Circuit Court of Appeals below correctly held that as to this interest inherited, in view of the express exemption granted by the statute, no part of the payments subsequently received by virtue of the inheritance constituted income until the full value of the amount inherited had been received by respond-

ent. Manifestly there is nothing new or novel in this ruling which is in strict accord with the express exemption granted by the Revenue Act of 1918, Sec. 213(b) 3, providing that the value of property acquired by gift, bequest, devise or descent shall be excluded from gross income.

II. *With respect to the inherited interest, there is no conflict of opinion and no basis for the issuance of a writ of certiorari. If a writ is issued because of conflicting opinions, this question should be excluded.*

The opinion of the Circuit Court of Appeals for the Sixth Circuit in the case of *Frank Hitchcock* v. *Commissioner*, set out in Petitioner's Memorandum, is in conflict with the opinion of the Circuit Court of Appeals for the Second Circuit in the present case only with respect to the first transaction above stated.

Contrary to the statement of counsel for petitioner (page 6 of Petitioner's Brief), an examination of the memorandum opinion of the Circuit Court of Appeals for the Sixth Circuit does not show that the Court in anywise considered or passed upon any question of inherited interest, such as is involved in the second situation above mentioned.

The answer to the second question seems clear and does not carry the general importance attributed to it by Government counsel. If it could have such importance, it is strange that the Government should have waited to this late date before applying for certiorari in view of the several opportunities open to it beforehand on what are now called similar questions in *Warner* v. *Walsh*, and related cases (see *infra*).

The thing inherited is a 550/4000ths interest in a right to future payments. The Government has singularly failed to include among the applicable provisions of the statutes, the Revenue Act of 1918, Section 213(b) (3):

> "Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income' * * * (b) Does not include the following items, which shall be exempt from taxation under this title: (3)

> The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income)."

The Government has plainly overlooked the fact that what the respondent received was *bequest*, not income from a bequest. As bequest, it is specifically exempt from taxation.

Three Circuit Courts of Appeals have successively held that payments made under a will to a widow in lieu of dower are purchases of the interest under the will and that the value of the dower interest surrendered should be fully restored before any part of the payments can be regarded as income. *Warner* v. *Walsh*, 15 Fed. (2d) 367 (C. C. A. 2d); *United States* v. *Bolster*, 26 Fed. (2d) 760 (C. C. A. 1st); *Allen* v. *Brandeis*, 29 Fed. (2d) 363 (C. C. A. 8th). Certiorari was not applied for in any one of these cases.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, accepted all of these cases as representing sound law. See respectively, *T. D. 4257*, *4258* and *4256* in VIII–1 Cumulative Bulletin, 245, 247, 243. Is it not just as sound that the value of the bequest must be restored before any part of the receipt thereof can possibly be regarded as income in any sense? Is not the decision below even stronger in view of Section 213(b) (3) above quoted?

In *Nichols* v. *Coolidge*, 64 Ct. Cls. 214, it was held that an executor collecting payments due to an estate did not receive income except to the extent that payments received exceeded the value at the date of death of the decedent. The Government applied for a writ of certiorari, but the petition was denied. 277 U. S. 584. The Board of Tax Appeals has repeatedly held in accordance with this decision, and the Commissioner of Internal Revenue has indicated by formal acquiescence that he accepted the principle laid down. *McCarthy, Ex'r*, v. *Commissioner*, 9. B. T. A. 525, Acq., VII–2 C. B. 26; *Hearn, Admx.*, v. *Commissionr*, 9 B. T. A. 1362, Acq. VII–2 C. B. 17; *Brown et al.* v. *Commissioner*, 10 B. T. A. 1036, Acq. VII–2 C. B. 5; *Nichols, Ex'r*, v. *Commissioner*, 10 B. T. A. 919, Acq. VII–2 C. B. 29, and other cases. The Commissioner has even pub-

lished rulings to the same effect. *I. T. 1383, I-2 C. B. 157; O. D. 1112, 5 C. B. 55; I. T. 1563, II-1 C. B. 49; G. C. M. 4983, VII-2 C. B. 136.*

Is a legatee in a worse position than the executor in view of Section 213(b) (3), exempting his bequest from taxation? This is apparently the first effort to impinge upon the express statutory exemption of bequests. No injustice is done to the United States, for a Federal Estate Tax was paid on the inheritance. On the same inheritance, the Government now asks for an *income tax*, without noting that it had already collected an estate tax on the same thing as an asset of the estate. The collection of the amount inherited was not a "sale or disposition" of the bequest. Adequate provision is made when income tax is paid on the amounts received in excess of the value of the bequest.

As to this branch of the case, which is a separate and distinct issue, it seems plain that there is no basis for certiorari. The importance is wholly imaginary, since there are no other cases involving such a principle and since to counsel's knowledge there has never been such a contention advanced in any other case. This Court denied the petition of the United States in *Nichols* v. *Coolidge*, where it tried to bring practically the same question before the Court. It is noteworthy, too, that an examination of the petitioner's brief in the Second Circuit fails to show that any sort of distinction was made by counsel between the amount received by bequest and the amount received as part of the purchase price of stock sold, and certiorari on this point would therefore be a review of a contention never made by the Government below.

We submit that on this point there is no direct conflict of decision, and certiorari, if granted, should be limited to the question of taxability, if any, of the payments for the transfer of the 250 shares.

III. *With respect to the sale of the stock the Court below has correctly held that no taxable income was received until there has been a return of Respondent's statutory base, to wit, the March 1, 1913, value of the shares sold. There*

is nothing new or novel in this, and certiorari should be denied, notwithstanding the conflicting opinion on this branch of the case by the Circuit Court of Appeals for the Sixth Circuit in Hitchcock v. *Commissioner of Internal Revenue.*

The decision below of the Circuit Court of Appeals for the Second Circuit on this branch of the case, we submit, is plainly correct. It states nothing new or novel in the application of the elementary principles governing the interpretation of our Federal income taxing statutes enacted since the adoption of the Sixteenth amendment to the Constitution. The elementary principles as applied by the Circuit Court of Appeals to the question of determining the gain or loss to respondent, on the sale of the stock, are in strict accord with the rulings of this Court. This Court has uniformly held that in determining gain or loss arising from a sale of stock or other capital assets, a taxpayer has a right to have restored to him the March 1, 1913, value of the stock or capital assets sold. *Goodrich* v. *Edwards*, 255 U. S. 527, 65 L. Ed. 758. Here, concededly, the total amount of the payments received by respondent since the sale of her 250 shares of stock, from the date of the sale down to and including the last taxable year in question, was less than the value on March 1, 1913, of the shares sold.

The chief source of confusion is that the Sixth Circuit gives no significance to the fact that respondent sold 250 share of stock and received in part cash and in part a promise to pay in the future, dependent on certain contingencies. When and as that promise is performed, there is not a second transaction; there is simply performance on the part of the purchaser. See *W. B. Geary* v. *Commissioner*, 6 B. T. A. 1109, 1112. There is but one sale; *one* disposition and that is a sale of stock. By fine spun theories of capitalization, the Sixth Circuit converts this simple transaction into two transactions: (1) a sale of the stock; (2) a disposition of the so-called contract right. The weakness of the whole case inheres in this theory of analysis.

The Sixth Circuit unqualifiedly accepted the Government analysis, which is as follows:

(1) The promise to make these future payments is a chose in action, has a present market value and is the equivalent of cash to the extent of $1,942,111.46, determined by making a series of assumptions and prophecies, and then applying Hoskold's formula. That, therefore, the sale of this stock is a closed and completed transaction, giving rise to gain or loss in the year 1916, as an exchange of property for property.

(2) That this value of $1,942,111.46 added to the cash payment of $2,200,000 is less than the March 1, 1913, value of the stock sold and greater than the cost of the stock sold, and, therefore, no gain is derived and, on the other hand, no loss is sustained because of this transaction in 1916.

(3) A new basis is formed by the acquisition of this contract right to future payments, which is "disposed of or sold," evidenced by the receipt of cash in each year. This disposition, as and when it is made, results in the derivation of income in part and in part constitutes the return of the value of the contract so disposed of, spread over the period in which it is assumed that payments will be made.

Respondent sold stock, not a contract right. The only question is: Did she make a *profit* or derive a gain from the sale of the stock and when did she receive that gain? Respondent reported income on the cash basis—as and when she received it. To say that a promise to pay in the future is a present receipt in 1916 to a person on the cash basis is bad accounting and confuses the accrual system of accounting with the cash receipts basis.

This Court very pointedly stated in *Commissioner* v. *American Code Co., Inc.*, decided February 24, 1930, 280 U. S. 445, 449; 74 L. Ed. 538, 540:

> "Generally speaking, the income-tax law is concerned only with realized losses, as with realized gains. Weiss *v.* Weiner, 279 U. S. 333, 335. * * * The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test. * * *"

See *Columbia State Savings Bank* (C. C. A. 7th), decided June 10, 1930, 41 Fed. (2d) 923, for the distinction between treating accrued income on notes between a taxpayer on the cash basis and a taxpayer on the accrual basis.

By a complicated analysis, what was intended to be a simple transfer of title to personal property for a promise to pay in the future is turned into two separate and distinct conversions and dispositions of property.

The Court then goes on to discuss "exhaustion of contract" and "return of capital" as if this were the case of a mine. The transaction here is a sale of stock. No profit is realized on *any* sale or disposition of property until the *cost* is recovered. This would seem to be elementary. If authority is necessary, see: *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 183; 62 L. Ed. 1054, 1059; *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 175; 70 L. Ed. 886, 888; *Lucas* v. *Alexander*, 279 U. S. 573, 577; 73 L. Ed. 851, 854; *United States* v. *Guggenheim Exploration Co.*, 238 Fed. 231; *Safe Deposit & Trust Co. of Baltimore* v. *Miles*, 273 Fed. 822, 824; *Mastin* v. *Commissioner*, 28 Fed. (2d) 748, (C. C. A. 8th). To find any gain before cost is recouped, not only offends common reasoning, but violates the Sixteenth Amendment to the Constitution, which taxes income only.

The Sixth Circuit assumed that attacks were being made upon its decision in *Eldredge* v. *Commissioner*, 31 Fed. (2d) 924. The case is not near the point. It involved the restoration of March 1, 1913, value of a contract right. *There was no question of gain or loss on the transaction.* By referring the subsequent receipts to March 1, 1913, value, the Court thereby premised that the entire receipts would be *income* except for the interpretation of the Sixteenth Amendment which absolves from income taxation all income accrued prior to March 1, 1913, but received subsequent thereto. That is not this case. This Court in *Lucas* v. *Alexander*, 279 U. S. 573, 580; 73 L. Ed. 851, 855, pointed out that there must first be a profit or a gain before March 1, 1913, value becomes material at all:

> "* * * For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date when

> income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913."

If the same principle is here applied, it was necessary for the Sixth Circuit, first of all, to find a realized gain. To call the deferred payments "an income-producing contract," begs the question. Cost must first be returned. There can be no gain until there has been recompense for the sacrifice made to secure it. "Income can not be created by fiat alone," said the Sixth Circuit in *Taplin* v. *Commissioner*, decided June 12, 1930, 41 Fed. (2d) 454.

Contingent rights are not capital and are not susceptible of valuation for determining gain or loss. *Workman* v. *Commissioner* (C. C. A. 7th), decided May 28, 1930, 41 Fed. (2d) 139. Compare a statement by the Sixth Circuit itself in *Morris Poston Coal Co.* v. *Commissioner* (C. C. A. 6th), decided June 28, 1930, Vol. 3, Federal Tax Service C. C. H., Par. 9465, that contingent rights subsequently paid do not and can not create income before payment.

The Court fails to point out any basis for exhausting the *value* of a contract right. In every other instance, *cost* is the basis for exhaustion, depletion and depreciation. Value and cost are not synonymous or even similar. The cost here is the value of the *stock* at March 1, 1913, since said stock was acquired before March 1, 1913. On the Court's own statement, there would be no taxable income on that basis:

> "* * * Consequently, if the capital value which petitioner is entitled to have returned is the value of the Andrews Company stock as of March 1, 1913, there is no showing of any tax liability for any of the years here involved. * * *"

This discussion need not be extended to examine the question of the marketability of such a promise to make future payments; to examine the assumptions on the basis of which the Government applied Hoskold's formula; to examine what

application such a formula could possibly have in determining gain or loss on the sale of stock; to examine why by this scheme of a "double sale" the Government deprives a taxpayer of a large amount representing the difference between the March 1, 1913, value of the stock (admittedly in excess of what was received in 1916), and the so-called value of this contract.

IV. *In the case of* Commissioner *v.* Garber, *now pending in the Circuit Courts of Appeals for the Ninth and Tenth Circuits, the Government is taking precisely the same position which it is asking this Court to reverse in this case.*

The case of *Garber* v. *Commissioner*, 11 B. T. A. 979, was decided by the Board of Tax Appeals on May 3, 1928. In 1918, Garber and others sold stock in an oil company for $500,000 cash, plus 200 oil and gas certificates calling for 20 per cent of the total gross receipts from the sale of all oil produced from the leases then owned by the oil company. The certificates were secured. On the same day, Garber and the others (under the form of an option) sold all the oil and gas certificates to the Sinclair Company for $2,500,000 to be paid over five years. The Government's contention in that case, as stated by the Board, was as follows (pages 985–6):

> "He (the Commissioner) determined that the taxable income should be ascertained by applying the consideration from the first and second transactions to the cost of the Garfield stock which was sold or exchanged in the first transaction. This application was made on the 'return of capital' theory, which contemplates the receipt by the taxpayer of his entire cost before there can be taxable income. The petitioners contend that the first of the transactions is complete in itself and that the income therefrom should be determined in accordance with the provisions of section 202(b) of the Revenue Act of 1918 * * *.
>
> "We think that the petitioners' contention is correct. There were two transactions, each separate and distinct from the other and each giving rise to income. When, in 1918, the petitioners sold or exchanged their Garfield stock for $500,000 in cash and the 200 certificates, they received cash and property having a fair market value

and derived income therefrom, the amount of which is immaterial here since the year 1918 is not before us. They derived no income from that transaction in the subsequent years."

The Government lost and appealed the cases. (See Vol. IV, Standard Federal Tax Service, page 3054, paragraph 719:16). The position which it is trying to establish in the Circuit Courts of Appeals is that the transaction was not "closed and completed" in 1918. Yet in those cases the Government is attempting to establish the very result and the same conclusion which it is asking this Court to review in the opinion of the Circuit Court of Appeals for the Second Circuit.

In fact, the Board cited (page 986) as analogous situations, *Kosmerl* v. *Commissioner*, 25 Fed. (2d) 87, and *Ruth Iron Company* v. *Commissioner*, 4 B. T. A. 1151, which have been and are relied on by the Government in the instant case. (See Petitioner's Brief, page 13.)

We submit that petition for certiorari in this case is not an effort to settle any general principles of taxation but is simply an effort to overcome an adverse decision below.

The decision of the Circuit Court of Appeals for the Second Circuit is in strict accord with the principles uniformly laid down by this Court in the cases which have come before it since the adoption of the Sixteenth Amendment to the Constitution, involving the determination of gain or loss on the sale of stock or capital assets, and, as no new or novel questions are presented, we submit it does not require review by this Honorable Court.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 521.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

EDITH ANDREWS LOGAN.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR RESPONDENT.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1930.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,
v.
EDITH ANDREWS LOGAN
Respondent.
} No. 521.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR RESPONDENT.

The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. 94–99), unanimously reversing the order of the United States Board of Tax Appeals (R. 33) is reported in 42 Fed. (2d) 193. The opinion of the Board of Tax Appeals, (R. 20–31), two members dissenting in part (R. 32), is reported in 12 B. T. A. 586. This opinion overruled, in part, a prior opinion of the Board of Tax Appeals in a case involving the same contract (Appeal of *Julia Andrews Bruce*, 5 B. T. A. 300). The opinion of the United States Circuit Court of Appeals for the Sixth Circuit, in the case of another taxpayer involving the transaction under consideration here is reported in *Hitchcock* v. *Com'r*, 44 Fed. (2d) 756, now pending on petition for rehearing.

The basis for jurisdiction in this Court is correctly stated in petitioner's brief.

Questions Presented.

Petitioner's statement of the question is confusing. Additional income taxes are asserted for the years 1918, 1919 and 1920. The questions presented are:

(1) Respondent in 1916 sold shares of stock for a cash payment and a promise by the purchaser to make further payments per ton, as, if, and when it received iron ore from a certain mine. The aggregate payments made up to December 31, 1920, were stipulated to be less than the March 1, 1913, value of the stock sold. Were any of the payments taxable as income?

(2) Respondent inherited in 1917 the right to receive similar payments from the purchaser on account of stock sold by her mother in 1916. The value of this inherited right was taxed by petitioner as part of her mother's gross estate. It was stipulated that the payments received by respondent up to December 31, 1920, were less than the amount at which petitioner taxed this inherited right as part of the estate. Were any of the payments taxable as income of respondent?

(3) Assuming, but not conceding, that any portion of the payments received by the respondent can be treated as income, was the Commissioner right in holding that 66.901% of each payment received by bequest, and 67.446% of each payment received during the taxable years in question from the sale, were taxable income?

Statement of Case.

On March 11, 1916, respondent sold to the Younsgtown Sheet & Tube Company, under a written contract, 250 shares of stock of the Andrews & Hitchcock Iron Company (R. 97-108), which she had acquired prior to March 1, 1913. The Andrews Company, an Ohio corporation, had a total outstanding capitalization of 4,000 shares. All of its stockholders were parties to the contract of March 11, 1916, and

under it sold their respective stockholdings. Mrs. Louisa Andrews, respondent's mother, a party to this contract, under it sold 1180 shares of the same stock, which had also been acquired by her prior to March 1, 1913 (Agreed Statement, R. 44).

At the time of the sale, the Andrews Company owned certain physical assets consisting of land, buildings and equipment (R. 61), and in addition 12 per cent of the capital stock of the Mahoning Ore & Steel Company, a Pennsylvania corporation, which was the lessee for 97 years from April 1, 1895, of certain mineral lands in the Mesaba Range of Minnesota (Agreed Statement, R. 44).

A 50 per cent interest in the Mahoning stock was held by the Cambria Iron Company. The balance of its stock was owned by other steel companies (R. 50). All the Mahoning stockholders, by contract dated December 16, 1914, had agreed as follows:

1. That the Board of Directors of the Mahoning Company should fix on or before April 1st, of each year, the annual tonnage of iron ore to be produced;

2. That each stockholder would be entitled to take, if he wished, a full quota of each grade of iron ore produced annually, in proportion to the amount of stock owned;

3. That the price of said ore should be fixed each year by the Board of Directors at or about the cost of production, including all costs of transportation, delivery, etc., to the lower lake ports (R. 49-51).

Neither the selling stockholders of the Andrews Company, nor the purchaser, the Youngstown Company, could agree upon the cash value of the 12 per cent minority interest in the Mahoning Company (R. 61, 62). The contract of sale with the Youngstown Company provided that the selling Andrews Company stockholders should receive a down payment of $2,200,000 in cash, and, as and for the balance of the purchase price, the Youngstown Company agreed to take annually the full quota of iron ore to which the Andrews

Company would be entitled under the contract of December 16, 1914, and to pay annually to the selling stockholders 60 cents for each ton of ore so entitled to be taken, and actually delivered or left at the mine by direction of the Youngstown Company (R. 46-49).

Under this contract, respondent received down to and including the taxable year 1920, for the 250 shares of stock sold by her, the following sums (Agreed Statement, R. 45):

1916	-	$137,500.00,	respondent's proportionate share of the $2,200,000 down payment.
1917	-	9,900.00	
1918	-	11,250.00	
1919	-	8,995.50	
1920	-	5,444.30	
Total	-	$173,089.80	

and the government conceded that the aggregate of these payments was less than the March 1, 1913, value of the stock sold (Agreed Statement, R. 45).

The respondent reported her income for the years in question on the basis of cash receipts and disbursements (Agreed Statement, R. 45). She included no part of the payments received from the sale during these years as income (R. 7-11).

Respondent's mother died on March 22, 1917, and respondent acquired by inheritance from her a 550/4000ths interest in any subsequent payments that might be made by the Youngstown Company under its contract for the purchase of the Andrews Company stock. The value of this interest was fixed by the Commissioner of Internal Revenue for the purposes of the Federal Estate Tax imposed upon the estate of Louisa Andrews at the sum of $277,164.50 (Agreed Statement, R. 44). Mrs. Logan, as payment of this bequest, received during the years in question a total of $31,767.59 (Agreed Statement, R. 45). She reported none of it as income (R. 7-11).

From these facts, in more or less obscure language of "depletion," "royalties," "ore payments," and "income-producing contracts," the Commissioner drew the following conclusions (R. 53-60):

(1) The promise of the Youngstown Company to make these future payments was "property" received and had a "determinable and assignable fair market value" in 1916, and such interest ought to be regarded as equivalent to cash in the amount of $1,942,111.46 (R. 46). This "market value" is determined by making a series of assumptions and prophecies, and then applying Hoskold's formula. Taking *only* 620 out of the 1,000 acres of mineral land leased by the Mahoning Company, the Government engineers estimated the ore reserves in said 620 acres at 82,858,535 tons (R. 45, 88); assumed that the future average production of ore would be 1,841,300 tons per annum; assumed that all of the ore would be mined out in 45 years (R. 45), and that the Andrews Company would be entitled to take 12 per cent of the total ore, or 9,942,564.2 tons, which at 60 cents per ton would result in total estimated payments of $5,965,814.52 and then determined the *present worth* of that sum on the assumption that it would be received in equal annual instalments during 45 years by discounting it at 6 per cent, with provision for a sinking fund of 4 per cent. This gave a "market value" of $1,942,111.46 (R. 46).

(2) Having found that these future payments had a "market value," the Commissioner concluded that the transaction was a closed and completed transaction in 1916, giving rise to gain or loss in that year.

(3) The Commissioner then added his "market value" of $1,942,111.46 to the cash payment of $2,200,000, and found the sum to be less than the March 1, 1913, value of the stock sold, but greater than the cost of the stock sold, and therefore, so far as 1916 was concerned, no gain was derived, and no loss was sustained.

(4) The Commissioner then concluded that this disposed

of the March 1, 1913, value, and a new basis was established, to-wit, a contract right to future payments, which is "disposed" of or converted into possession by the receipt of cash in each year. This disposition or conversion, as and when it is made, results in derivation of income in part and in part constitutes the return of the value of the contract so disposed and converted, spread equally over the period in which it is assumed that payments will be made. The proportion is 32.554 per cent return of contract right, and 67.446 per cent income. The percentage of capital is determined by taking $1,942,111.46, "fair market value" of the contract right "sold or disposed of," and dividing it by the total amount that should eventually be received if all the assumptions prophesied by petitioner should become facts, to-wit, $5,965,814.52.

The proportion of "capital" in respect of the inherited payments was determined by dividing the value used for the Estate Tax levy by the total anticipated payments from that date, resulting in the conclusion that 33.099 per cent represented a return of inherited right and 66.901 per cent constituted gain or income.

(5) Treating the payments received by the taxpayer as royalties or "ore payments" subject to depletion (R. 7-11), instead of payments for stock sold, and payments on account of a bequest, the Commissioner proposed the deficiencies complained of on the above basis. The Board approved the determination (R. 13-33) on the same basis.

The Circuit Court of Appeals refused to find that it is necessary to go through such an intricate process to find a gain on the sale of stock. It held that there were so many uncertainties involved in the future receipt of the 60 cents a ton by the selling stockholders, and "ample testimony satisfactorily establishing that there was no market for the sale of the obligation to pay the 60 cents per ton for 45 years, and it had no cash equivalent," (R. 97); that, as respondent concededly never recouped the March 1, 1913,

value of the stock sold, or the value fixed for the bequest for the purpose of a Federal Estate Tax, no taxable income has been received by her (R. 94-99).

What is more, the Government suggests in this court, and for the first time, that the whole of the payments is taxable income and no part is a return of capital, but that it is satisfied not to disturb the prior determination. The Government contention comes to this: A taxpayer sells stock and receives part payment in cash. The Government concedes that the cash payment of $2,200,000 is *at least* $1,942,111.46 less than the March 1, 1913, value of the stock sold, but contends that every dollar after that first cash payment is taxable income.

SUMMARY OF ARGUMENT.

The contract of March 11, 1916, was a sale of stock and not an exchange of property for property, so that there is no taxable gain until the aggregate payments exceed the March 1, 1913, value of the stock. The fact that part of the payments for the stock is spread over the future years does not operate to exclude the March 1, 1913, value of the stock as the basis for computing gain. The Commissioner's determination deprives this taxpayer of the benefit of using the March 1, 1913, value as its basis. Before there is any taxable gain, the consideration must be received and must be cash or readily reducible to cash. The promise to pay cannot be considered the equivalent of cash nor can a present tax be based upon the expectation of future profit, or the determination of a paper profit, to a taxpayer reporting income on the cash receipts basis.

The existence of a fair market value for such a promise is a mixed question of law and fact on which the Board of Tax Appeals findings and conclusions are not binding. "Fair market value" for purposes of computing gain or

loss contemplates the existence of supply and demand and contemplates the receipt of a fair price for the property evaluated, and must be distinguished from the so-called intrinsic value, or the existence of some value.

The promise to pay in this case is so contingent, uncertain and indefinite that it cannot be considered the equivalent of cash or to have a "fair market value," and the finding of the court below to this effect is amply supported by the conceded facts and the evidence. The assumptions on which the Commissioner's determination is founded are clearly contrary to the evidence and are so far fictitious that they serve but to indicate the absence of any market value. The promise to make future payments, having no fair market value and not being the equivalent of cash, the value at March 1, 1913, of the stock sold is the proper basis for measuring taxable income, and the taxpayer is entitled to recoup that value before there is any realization of gain subject to income tax.

As to the interest in the payments bequeathed to Mrs. Logan, she received no taxable income until the amounts received by her exceeded the value at which they were included in the gross estate for Federal Estate taxation, since said payments represented a bequest to her, which is specifically exempted from income tax.

Even if the sale were a closed and completed transaction in 1916, the apportionment of each payment thereafter into capital and income as made by the Board of Tax Appeals and the Commissioner in each year is wrong. The Commissioner's theory contemplates the receipt of fixed sums for a period of 45 years. Such payments would be analogous to annuities, and on that basis the entire cost of the payments must be fully deducted before any part of the payments constitute taxable income, and that principle has been consistently upheld by administrative and judicial determination and finally by statutory enactment. If that principle is not applied to this case, the apportionment of each pay-

ment into income and capital should be made on the same basis on which the present value of the payments is computed. On that basis, the earlier payments represent a larger proportion of capital and a smaller proportion of interest, and as the payments fall in, the capital proportion decreases and the income proportion increases.

ARGUMENT.

I. THE TRANSACTION OF MARCH 11, 1916, WAS A SALE OF STOCK AND NOT AN EXCHANGE OF PROPERTY FOR PROPERTY, SO THAT THERE IS NO TAXABLE GAIN UNTIL THE AGGREGATE PAYMENTS EXCEED THE MARCH 1, 1913, VALUE OF THE STOCK.

Petitioner does not dispute that in the case of a sale of property acquired before March 1, 1913, there is no taxable gain until the payments received exceed the March 1, 1913, value (see pp. 31 and 8 of Petitioner's Brief). Without briefing the point at all, petitioner assumed that this is a case of an "exchange of property for property." The analysis fails at this point, and since the remaining steps are dependent on this premise, they too must fail.

Mrs. Logan transferred stock for part payment in cash plus a contingent promise to make further payments measured by future ore deliveries to be made by the Mahoning Company to the purchaser. That is a *sale* of stock, not an exchange of property. "Sale" as here used implies a monetary consideration and differs from an exchange in that the latter implies a consideration in goods or merchandise susceptible of valuation (Bouvier's Law Dictionary, 3rd ed. "Sale"). Simply because the promise to pay is executory, the transaction is not converted from a sale to an exchange of property.

In the court below, the Government called this promise

"an income-producing contract," and the Sixth Circuit so referred to it and thereby begs the question (*Hitchcock* v. *Commissioner* (C. C. A. 6th), 44 Fed. (2d) 756, 757). The Government tacitly assumes the same position in this court, although the Commissioner formerly denominated it and treated the transaction as a sale (R. 58, 60).

The Board of Tax Appeals has held that similar transactions are sales and not exchanges. *J. H. Johnson, et al.* v. *Commissioner,* 19 B. T. A. 840; *Pinellas Ice and Cold Storage Co.* v. *Commissioner,* 21 B. T. A. 425; *Geary* v. *Commissioner,* 6 B. T. A. 1109.

In determining the gain, if any, on the sale of property, the March 1, 1913, value must be deducted before there is any taxable gain. This is plainly required by the Revenue Act of September 8, 1916 (Sec. 2(c), c. 463, 39 Stat. L. 758):

> "(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived."

Section 202(a) (1) of the Revenue Act of 1918 is to the same effect (c. 18, 40 Stat. L. 1057) (Appendix).

This court's decisions unanimously hold that there is no taxable gain on the sale of personal property acquired before March 1, 1913, until the amounts received or realized by the vendor exceed the March 1, 1913, value. *Goodrich* v. *Edwards,* 255 U. S. 527, (1921); *Doyle* v. *Mitchell Bros.,* 247 U. S. 179, (1918); see *Burnet, Com'r,* v. *Thompson Oil & Gas Co.,* (U. S.), decided April 13, 1931. The principle is aptly stated in *Lucas* v. *Alexander,* 279 U. S. 573, 580, (1929):

> "* * * For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date

when income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913."

Cases relied upon by petitioner and the Sixth Circuit as recognizing that deferred installments of purchase price include an element of income are not in point. *Ruth Iron Co.* v. *Commissioner of Internal Revenue* (C. C. A. 8th), 26 Fed. (2d) 30; *Kosmerl* v. *Commissioner of Internal Revenue* (C. C. A. 7th), 25 Fed. (2d) 87; *Platt* v. *Bowers* (S. D. N. Y.), 13 Fed. (2d) 951; *Eldredge* v. *United States* (C. C. A. 6th), 31 Fed. (2d) 924. In all of these cases, the transaction was completed before March 1, 1913, and the question was simply one of returning the March 1, 1913, value of certain rights to future payments, which value the statutes and the Sixteenth Amendment require to be returned as capital before any part of their later conversion into cash can be considered income. These cases do not involve the question of whether there is any gain upon a sale after March 1, 1913, before the March 1, 1913, value of the property sold is returned, nor do they involve the question as to whether a promise to pay at some indefinite future time an indefinite sum of money in consideration for the transfer of stock has a present market value for the determination of gain, before the contingencies occur, which make the promise enforcible, and before the promise is performed.

It is stipulated that the total payments received by the respondent from the sale of her 250 shares of stock, down to and including the year 1920, was less than the March 1, 1913, value of the shares sold (R. 45). It can be seen by a simple mathematical computation how the Commissioner's method deprived the selling stockholders of their rights fixed by statute and decisions of this court to have returned to them the March 1, 1913, value of the shares sold before

taxable gain is realized. The Commissioner determined that the entire 4,000 shares of stock sold had a March 1, 1913, value of more than $4,142,111.46 (Footnote 1). Of this amount, the vendors received $2,200,000 in cash in 1916, as a down payment, and over the period of years to December 31, 1920, $569,436.80 (Footnote 2). The balance of $1,372,674.66, conceded March 1, 1913, value, was not restored up to December 31, 1920. In an ordinary case, gain is computed only when the amount received exceeds the March 1, 1913, value of the property sold and no gain is realized and hence no part of the receipts is taxable until the March 1, 1913, value is exceeded. The fact that some of the payments are spread over a series of years does not render the statute inoperative and cause something less to be restored, to-wit, the supposed present value determined by mathematical formula of these future contingent payments.

Even the Sixth Circuit in the *Hitchcock* opinion stated (44 Fed. (2d) 757):

> "Consequently, if the capital value which petitioner is entitled to have returned is the value of the Andrews Company stock as of March 1, 1913, there is no showing of any tax liability for any of the years here involved."

The Court's error consists in holding that a promise to pay on the contingencies specified in this case is equivalent to a cash payment of $1,900,000 for the stock and that the transaction is thereby closed.

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(1) The Income Tax Unit found the present value of the future payments to be $2,049,018.65 (R. 57). The Committee on Appeals and Review changed this to $1,942,111.46 (R. 46). By adding this present value to the cash payment in 1916, the Bureau found that the total was *less* than the March 1, 1913, value of the stock and there was no gain in 1916 (R. 57).

(2) Mrs. Logan received 250/4000ths of the subsequent payments made, or $35,589.80. The total payments for the 4000 shares was 16 x $35,589.80 or $569,436.80 (R. 45).

II. BEFORE THERE IS ANY TAXABLE GAIN, THE CONSIDERATION MUST BE RECEIVED AND MUST BE CASH OR READILY REDUCIBLE TO CASH.

Mr. Judge Learned Hand in *Bedell* v. *Commissioner of Internal Revenue* (C. C. A. 2nd), 30 Fed. (2d) 622, 624 (1929), has pointed out that a transaction similar to that here involved cannot be treated as a closed and completed transaction until the promise to make the future payments is performed. His statement cannot be abbreviated without destroying the thought:

> "* * * While equity regards a vendee before payment as owner, still the payment is for the title, and is conditional on its delivery, as much as in the case of chattels where title has not passed. Of course, it is true that an obligation, even a conditional obligation, is in some sense property, and, like anything else that can be transferred, may be said to have a value, but nevertheless payment is made in exchange for title, and will never be made if it is not conveyed. To speak of the profit as resulting because its amount can be presently ascertained, though performance remains uncertain, seems to us a perversion of language.
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> * * * * * * *
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> "While, therefore, we do not think that the case is like a promise to pay in the future for a title which passes at the time of contract, we would not be understood as holding by implication that even in that case the profit is to be reckoned as of the time of sale. If a company sells out its plant for a negotiable bond issue payable in the future, the profit may be determined by the present market value of the bonds. But if land or a chattel is sold, and title passes merely upon a promise to pay money at some future date, to speak of the promise as property exchanged for the title appears to us a strained use of language, when calculating profits under the income tax. Section 202(b) of the Act of 1918 provided for an exchange of property and made

> the profit depend upon 'the amount of its (the property received) fair market value if any'—a phrase which was amended in the law of 1921 (42 Stat. 227) to 'readily realizable market value.' There is a difference between the two, but it is absurd to speak of a promise to pay a sum in the future as having a 'market value,' fair or unfair. Such rights are sold, if at all, only by seeking out a purchaser and higgling with him on the basis of the particular transaction. Even if we could treat the case as an exchange of property, the profit would be realized only when the promise was performed. We agree with the Board upon the first point."

The expectation or prospect of profit does not give rise to a taxable transaction. The gain must be realized. *Lynch* v. *Turrish*, 247 U. S. 221, 230 (1913); *Safe Deposit & Trust Co.* v. *Miles* (Dist. Md.), 273 Fed. 822, 825 (1921); *Weiss* v. *Stearn*, 265 U. S. 242, 252 (1924). This is best stated in *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445, 449 (1930):

> "Generally speaking, the income-tax law is concerned only with realized losses, as with realized gains, Weiss v. Weiner, 279 U. S. 333, 335. * * * The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test. * * *"

In the following cases on sales of property, the courts found that the gain, if any, is postponed to the date of realization. *U. S.* v. *Schillinger* (Cir. Ct. S. D. of N. Y.), 14 Blatch. 71 (1876), Fed. Cas. No. 16,228; *U. S.* v. *Christine Oil and Gas Co.* (Dist. Ct. W. D. La.), 269 Fed. 458 (1920); *Bourn* v. *McLaughlin* (Dist. Ct. N. D. Cal.), 19 Fed. (2d) 148 (1927); *Tsivoglou* v. *U. S.*, 27 Fed. (2d) 564 (1928); (Dist. Ct. Mass.) affirmed 31 Fed. (2d) 706.

Here the Commissioner and the Board have spelled out a paper profit which they are attempting to treat as an actual profit in hand for tax purposes. The taxing statutes and

regulations are simply aids in arriving at income, and cannot be used to create income. *Taplin* v. *Commissioner* (C. C. A. 6th, 1930), 41 Fed. (2d) 454, 456.

A taxpayer on the cash basis may not deduct a liability on a note until he pays his note. *Eckert* v. *Commissioner of Internal Revenue* (U. S.), decided April 13, 1931. Neither does it seem that a taxpayer on the cash basis realizes income until a promise to pay him money is performed and exceeds the statutory base of property sold for the promise.

III. THE CONSIDERATION CONSISTING OF A PROMISE TO MAKE PAYMENTS IN THE FUTURE, UNCERTAIN IN AMOUNT, FOR A PRESENT TRANSFER OF STOCK ON MARCH 11, 1916, WAS NOT THE EQUIVALENT OF CASH, AND HENCE, THE TRANSACTION WAS NOT A CLOSED AND COMPLETED TRANSACTION IN 1916.

Petitioner argues that the question whether the property has a fair market value is one of fact, and that the Board of Tax Appeals found that the contract had a determinable market value, and there was no evidence showing that the value determined by the Commissioner was erroneous (Petitioner's Brief, p. 13), entirely overlooking the fact that the court below carefully pointed out in its opinion the many uncertainties involved in the future payments to be made under the contract and affirmatively found that there was ample testimony establishing that there was no market for the sale of the obligation to make future payments (R. 97).

On the facts here, the determination of whether the promise to pay contained in the contract of March 11, 1916, is the equivalent of cash, or had a "fair market value" is primarily one of law. The conclusion which the Board seems to draw is that a promise, merely because it has some value,

can be said to have a "fair market value" or be the equivalent of cash (R. 23, 24). But irrespective of whether the question is one of law or fact, the undisputed facts, supported by the testimony offered before the Board, show conclusively that the Circuit Court of Appeals was right in its ultimate conclusion that the contract could not be deemed to have a fair market value or be considered the equivalent of cash, and that the Board's finding to the contrary was clearly unsupported by the record. The facts and testimony bearing on this question are fully discussed under our next point, and under such circumstances, it is well settled that the Circuit Court of Appeals has power to reverse the determination of the Board. *Ox Fibre Brush Company* v. *Commissioner*, 32 Fed. (2d) 42 (C. C. A. 4th); *Kendrick Coal & Dock Company* v. *Commissioner* (C. C. A. 8th), 29 Fed. (2d) 559; *St. Paul Abstract Company* v. *Commissioner* (C. C. A. 8th), 32 Fed. (2d) 225; *Royal Packing Co.* v. *Comr.* (C. C. A. 9th), 22 F. (2d) 536; *Bishoff* v. *Comr.* (C. C. A. 3rd), 27 F. (2d) 91.

The question is whether any such value can be definitely ascertained to the extent that a taxpayer can be taxed for a profit merely because he is the promisee and taxed on that profit *before* performance. Such a fair market value presupposes that it can be determined with substantial certainty and without undue complexity. Algebraic formulae for determining value are not lightly to be imputed to legislators. *Edwards* v. *Slocum* (C. C. A. 2nd), 287 Fed. 651. When such a formula yelds only a value of 32 per cent of the assumed future payments, it is seriously open to question whether such a promise has an ascertainable market value or is equivalent to cash. A fair and reasonable value is contemplated. *Phillips* v. *U. S.* (W. D. Pa.), 12 Fed. (2d) 598, 601; *Clarke* v. *Welch* (So. D. Cal. 1930), 46 Fed. (2d), 563, 564.

Cash equivalents are and should be limited to things that are readily saleable, or are subject to discount. The Com-

missioner himself has ruled that promises to be evaluated should be evidenced by notes or other transferable medium. *G. C. M. 1387, VI-1 C. B. 48; G. C. M. 3350, VII-1 C. B. 62.* See also *Ruprecht* v. *Commissioner,* 16 B. T. A. 919, affirmed in 39 Fed. (2d) 458 (C. C. A. 5th); *J. H. Johnson* v. *Commissioner,* 19 B. T. A. 840.

One element contemplated in the finding of a "fair market value" for property is a market price ascertained by sales, i.e., the existence of supply and demand as distinguished from the necessity of developing a buyer or seller. *Walter* v. *Duffy* (C. C. A. 3rd), 287 Fed. 41; *Bedell* v. *Commissioner* (C. C. A. 2nd), 30 Fed. (2d) 622). The existence of a so-called intrinsic value is not sufficient to support a fair market value for purposes of computing gain or loss. *Bourn* v. *McLaughlin* (No. D. Cal.), 19 Fed. (2d) 148; *Tsivoglou* v. *U. S.,* 27 Fed. (2d) 564 (Dist. Ct. Mass.), affirmed in 31 Fed. (2d) 706.

The Sixth Circuit in *Hitchcock* v. *Commissioner,* 44 Fed. (2d) 756, 758, attempted to distinguish the two latter cases on the theory that they dealt with values for purposes of gain or loss on property given in exchange. They then say (p. 758):

> "* * * In this case the value was fixed, not to determine gain or loss on the stock but for the purpose of apportioning the earnings from the contract to capital and gain. * * *."

It is obvious that the court is wrong. The very purpose of fixing the present value of the promise to pay was to compute the *gain or loss* in 1916 on the sale. The Commissioner then took this assumed value for the basis of computing income in future payments, contending that as payment was received, a percentage of the original contract was exhausted.

A promise as contingent in nature as this cannot be considered income or the equivalent of money under any

system of accounting. *L. O. 1086, I-1 C. B. 87; Woods* v. *Lewellyn*, (C. C. A. 3rd), 252 Fed. 106; *Morris Poston Coal Co.* v. *Commissioner* (C. C. A. 6th, 1930), 42 Fed. (2d) 620). See *Workman* v. *Commissioner* (C. C. A. 7th), 41 Fed. (2d) 139. A fortiori, it would not give rise to gain to a taxpayer on the cash basis.

IV. THE PROMISE TO PAY IN THIS CASE IS SO CONTINGENT, UNCERTAIN AND INDEFINITE THAT IT CANNOT BE CONSIDERED THE EQUIVALENT OF CASH OR TO HAVE A "FAIR MARKET VALUE," AND THE FINDING OF THE COURT BELOW TO THIS EFFECT IS AMPLY SUPPORTED BY THE CONCEDED FACTS AND THE EVIDENCE.

Neither a maximum or minimum tonnage nor maximum or minimum payment is provided for by the contract of sale. On the contrary, the tonnage to be mined in each year was subject to the determination of the Board of Directors of the Mahoning Ore & Steel Company on April 1 of each year. A minority stockholder obviously could not and would not control the Board of Directors which would subserve the interests of the majority stockholders. The testimony of the former general superintendent of the Mahoning Ore & Steel Company makes this very plain (R. 69). He states (R. 79):

> "* * * I mean, here were a group of men, six of them, all administering, or most of them, as presidents of various steel companies, with all of the ramifications that they involve. Now, they gathered together and said, 'We want this many tons out of there.' I have seen them change their minds two or three times in six months, but it would be pure supposition on my part to try to say what factors determined them in setting that tonnage. * * *"

The stock sold represented but a 12 per cent interest in the Mahoning Company, and the amount of ore to be mined annually was subject at all times to fluctuation, modification, and even possible extinction by the action of the majority holders in the mining company. This is noteworthy from the number of shifts that have occurred in the stockholdings of the operating company since March 11, 1916. In 1916, the stock was held as follows (R. 50):

Republic Iron & Steel Company	6%
Andrews & Hitchcock Iron Company	12%
Certain individuals represented by trustees	12%
Carnegie Steel Company	20%
Cambria Steel Company	50%

The Cambria Steel Company transferred its holdings to the Midvale Steel & Ordnance Company (R. 68). In 1923, the Midvale Company transferred all its holdings to Bethlehem Steel Company. Thus the control is now in the hands of the Bethlehem Steel Company (R. 78). The center of control is constantly shifting. The Youngstown Sheet & Tube Company is a minority stockholder.

It is a matter of common knowledge that in 1916 and at frequent intervals since that time there has been a movement to consolidate the so-called independent steel companies. Every such transfer involves a readjustment of mine operating policy on the basis of the needs and the aggregate mineral resources of the newly formed group. That this was fully appreciated by the President of the Company is shown by his testimony (R. 61):

> "A. * * * I mean the Andrews & Hitchcock Iron Company being a minority stockholder in the Mahoning Ore & Steel Company, I did not think there was any chance of getting a cash value for the property, and did not bring it up, as to its worth. I mean cash value as to its worth."

(R. 62):

> "Q. Did I understand you to say that you did not think there was any chance of getting the cash value of the Mahoning property? A. Yes; I said that. There was no chance of getting the cash value, on account of the minority holdings."

Even the Government witnesses concurred in the statement that the production is dependent on very uncertain factors which cannot be foreseen with any degree of accuracy. For example, their principal witness stated (R. 85):

> "* * * There are other elements more important—economic conditions, especially in the steel industry, and the number of properties operated by the company operating this particular mine also has a very important bearing, together with the terms of the leases as compared with other leases, and the local conditions of this mine; that is, it may be to the operating company's advantage to curtail operations at one mine and increase them at another. * * *"

Their other witnesses testified (R. 89):

> "I am not so certain as to what the probable life of any particular property may have been. That would depend upon the program of the operator."

On such evidence it is difficult to conceive that anything can be reasonably predicted as to the amount, or the certainty, of production, and yet petitioner wishes this Court to concur in the assumption that for a period of 45 years there will be delivered to the Youngstown Company from the Mahoning mine 1,841,300 tons per annum. In point of fact over the period from 1913 to 1926, the annual production varied from a low of 303,000 tons in 1921 to a high of 3,029,865 tons in 1923 (R. 46).

The assumptions on which the Government founds the valuation of this promise to pay for reducing it to a cash

equivalent are not supported by the evidence and are of such a character that they cannot be made the basis for determining gain or loss for income tax purposes.

There were about 1,000 acres of mineral bearing lands under lease by the Mahoning Ore & Steel Company. The Government's estimate was admittedly based on the content of recoverable ore in only 620 acres out of the entire property leased (R. 45). The Government engineer testified that the remaining tracts of approximately 400 acres were *mineral bearing* (R. 87-88).

To base even an intrinsic value on the assumption that there were only 82,858,535 tons of recoverable ore, which covers only 3/5ths of the total mineral bearing land, is plainly unreasonable.

The second assumption made is that the average annual production will be 1,841,300 tons. This seems to be the average for the years 1913 to 1920, inclusive, but the sale occurred in 1916. The estimate that the future production will be 1,841,300 tons per annum upon the basis of past history, no matter what years may have been used, is necessarily based on a prophecy that future history will present substantially the same conditions that occurred in the past. But such a prophecy is plain fiction. The average for the period 1900 to 1913 (R. 77) is approximately 1,100,000 tons, and for the period 1913 to 1926 (R. 46) approximately 1,750,000 tons, an increase of more than fifty per cent. A similar comparison for the entire Lake Superior region shows an increase in an even greater proportion, from an average of 32,500,000 tons to an average of 51,500,000 tons (Crowell & Murray, *The Iron Ores of Lake Superior, 1927*). Yet the Commissioner, in effect, estimates that from 1927 to 1961 the output of the Mahoning Mine will not exceed the average for the thirteen years from 1914 to 1926 by more than about six per cent. In 1871, the production of iron ore in the United States was approximately five million tons. Who, in that year, would

have ventured to predict that forty-five years later, in 1916, it would prove to be seventy-five million tons?

The plan was to produce 3,000,000 tons (R. 78). The Government engineer himself stated that "the production varies very greatly from year to year" (R. 86). In considering the prophecy in 1916, greater credence can hardly be accorded to the testimony of men who visited these properties in 1923 and 1925 and who had no part in fixing the valuation arrived at in this particular case (R. 86, 87), than to that of a general superintendent who was almost daily on the properties for a period of 20 years and knew it infimately from the operating standpoint. He testified that the future production could not be estimated with reasonable certainty (R. 69).

The Commissioner in this very case laid down the following principle (R. 59):

> "It (the fair market value) implies the existence of a public of possible buyers at a fair price. The adjective 'fair' emphasizes the idea of fairness inherent in this conception of market value and excludes any possibility of a construction of the words 'market value' with reference to a market in which, or to circumstances of sale under which, for any reason, a fair price could not be obtained."

But he failed to observe the principle in application.

Before the Board, respondent produced ample evidence showing there was no market in which such a promise to pay could be sold, nor were there any sales of similar agreements or prices established which enabled such agreements to be evaluated. Messrs. Hitchcock, Putnam and Agnew all testified to this effect (R. 61, 64, 75, 76), and the Circuit Court of Appeals termed their evidence "ample" to establish the non-existence of a market. The petitioner's only witnesses, two Government engineers, wholly failed to meet the issue raised by the testimony offered by the respondent. The most that can be said for the testimony of

the Government engineers is that it went to show that mining properties in the Mesaba district had been valued for the purpose of fixing a depletion rate or had been bought and sold at fixed prices and payment made in promissory notes extending over a long term of years (R. 86-90). They did not know of any case where a market value was attempted to be set upon a contract right similar to that involved here (R. 87). Sales of ore properties are not an indication of an existence of market value for a promise to pay such as here involved. In this very sale, a cash equivalent was not even considered by the parties to the sale (R. 61, 62).

The Government's resort to valuation of such a promise to pay by Hoskold's formula indicates the absence of a cash equivalent which is necessary to the computation of gain on sale of the stock. The formula requires (1) that the money be received in equal yearly payments for a fixed number of successive years; (2) that the amount to be received in each year must amount to a certain total sum which is known and fixed beforehand, in this case, the total prophesied receipts of ore payments. In ordinary affairs of men, Hoskold's formula is never used for such purposes. The Treasury regulations have condemned this method of valuation. See *Art. 202, Regs. 69.* It was also rejected by the Board in *Owens Bottle Co.* v. *Commissioner,* 8 B. T. A. 1197, 1217, and by the Circuit Court of Appeals for the Tenth Circuit in *U. S.* v. *Garbutt,* 35 Fed. (2d) 924, 926.

The whole conception of the formula that a sinking fund is set aside for amortization of the capital on which the taxpayer begins was denied by President Hoover in his *"Principles of Mining,"* p. 44:

> "In the practical conduct of mines or mining companies, sinking funds for amortization of capital are never established. In the vast majority of mines of the class under discussion, the ultimate duration of life is unknown, and therefore there is no basis upon which

to formulate such a definite financial policy, even if it were desired."

In any event, facts shown by reliable evidence are preferable to averages based upon assumed probabilities. *Pacific Gas & Electric Co.* v. *San Francisco*, 265 U. S. 403, 406. Nor can present value methods be used by taxing officials in an effort to create a *market value* or cash equivalent where there is none.

> "Taxes are not laid and collected on theory, but on a situation actually existing, as the facts may show that situation to be. Theory is applied in the absence of such facts. The question of taxation is one of fact, and cannot turn on theories or fiction." *Haugh & Keenan Storage & Transfer Co.* v. *Heiner* (Dist. Ct. W. D. Pa.), 20 Fed. (2d), 921, 923.

With a striking inconsistency the Commissioner fixes the rate of interest included in each payment at a rate of 6 per cent, at the same time as he fixes 4 per cent as the reasonable rate of return upon safe investments.

From the tables, it may be determined that the percentage of capital contained on the Bureau's theory in the aggregate deferred payments varies according to the interest factor used, as follows:

(1) 6% with 4% sinking fund.....32.55%
(2) 6% ignoring sinking fund.....34.34% or 105% of (1)
(3) 5% ignoring sinking fund.....38.43% or 118% of (1)
(4) 4% ignoring sinking fund.....46.04% or 141% of (1)

If the two assumptions in regard to interest rates are not grossly inconsistent, they can be reconciled only on the ground that the purchaser would have required a rate higher than the rate on safe, readily marketable securities for one of two reasons—either that the property here involved would not be readily realizable, or that the assump-

tions on which he was acting were fraught with grave uncertainties. Either explanation immediately destroys the validity of the Commissioner's method.

The question at issue is not which of various estimates that might be made is the most reasonable; it is whether in the circumstances any of them can be said to be the equivalent of cash, having in mind that if any property received is to be treated as the equivalent of cash, the first essential is that the amount of cash to which it is equivalent can be substantially approximated.

Adopting the Commissioner's own basis, we submit that the undisputed evidence shows that the computation should more reasonably be as follows:

Total tonnage in mine at March 1, 1913, as estimated by Commissioner in the Mahoning Ore & Steel Company depletion proceedings (R. 46)	88,561,533	tons
Mined from March 1, 1913, to March 11, 1916 (R. 46)	5,439,655	"
Estimated tonnage at March 11, 1916	83,521,878	"
Proportion receivable by Youngstown Sheet & Tube Company, 12% thereof	10,022,625	"
Payments by Youngstown at 60 cents per ton	$6,013,575.00	
Life of mine at March 1, 1913, as estimated by the Commissioner in Mahoning depletion case (R. 46)	40 years	
Expired at March 11, 1916	3 "	
Unexpired at March 11, 1916	37 years	
Average annual instalments to be received, 1/37th of $6,013,575		$162,529.05
Present value of $1 per annum for 37 years at 5%		$16,711.29
Present value of $162,529.05 receivable in equal instalments over 37 years		$2,716,070.09

It will be observed that the final figure exceeds the Commissioner's valuation by nearly forty per cent (actually 39.85%); yet the only changes made are in estimate of tonnage rate of mining to bring the computation into conformity with the Commissioner's conclusions in the Mahoning depletion case, and the change in the discount rate to five per cent, which was the rate adopted and approved of in the *Ruth Iron Company* case, 4 B. T. A. 1151, relied upon by the Board in its opinion.

If it is not conceded that the alternative method is a

more reasonable computation than the Commissioner's, it cannot be denied that it is at least as reasonable; and if two equally reasonable estimates differ by forty per cent, it cannot be claimed that either can represent a market value which is the equivalent of cash. The Commissioner cannot rightfully conclude from the same data that the life of the mine in one case was 45 years from 1916 and in another was 40 years from 1913.

V. THE PROMISE TO MAKE FUTURE PAYMENTS, HAVING NO FAIR MARKET VALUE AND NOT BEING THE EQUIVALENT OF CASH, THE VALUE AT MARCH 1, 1913, OF THE STOCK SOLD IS THE PROPER BASIS FOR MEASURING TAXABLE INCOME, AND THE TAXPAYER IS ENTITLED TO RECOUP THAT VALUE BEFORE THERE IS ANY REALIZATION OF GAIN SUBJECT TO INCOME TAX.

The proposition that Mrs. Logan has no taxable gain as the result of the sale of her stock, if the promise to make future payments had no exchangeable or fair market value in 1916, until the cash payments received offset the statutory basis of the stock sold, is not disputed in this case and has been consistently recognized by the Board of Tax Appeals and the Commissioner (*Art. 1564, Regs. 62*). Art. 46, Regs. 65, states this well:

> "If the obligations have no fair market value, the amount of the initial payment shall be applied against and reduce the basis, as provided in Section 204 and Articles 1591-1603, of the property sold and if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the basis as provided above and the amount realized therefor."

Bourn v. *McLaughlin* (D. Ct. N. D. Cal.), 19 Fed. (2d) 148.

Tsivoglou v. *U. S.*, 27 Fed. (2d) 564 (1928).

Leroy G. Evans v. *Commissioner*, 5 B. T. A. 806, Acq. VI-2 C. B. 2. (Acquiescence means that the decisions are regarded as reliable authority in tax administration.)

Joliet-Norfolk Farm Corp. v. *Commissioner*, 8 B. T. A. 824, Acq. VII-1 C. B. 16.

D. M. Stevenson v. *Commissioner*, 9 B. T. A. 552, Acq. VII-1 C. B. 30.

C. L. Starr v. *Commissioner*, 9 B. T. A. 886, Acq., VII-2 C. B. 38.

John T. Kennedy v. *Commissioner*, 16 B. T. A. 1372.

Woodmar Realty Co. v. *Commissioner*, 17 B. T. A. 88, Acq. IX-1 C. B. 59.

Old Farmer's Oil Co., 12 B. T. A. 203, Acq. VII-2 C. B. 30.

VI. AS TO THE INTEREST IN THE PAYMENTS BEQUEATHED TO MRS. LOGAN, SHE RECEIVED NO TAXABLE INCOME UNTIL THE AMOUNTS RECEIVED BY HER EXCEEDED THE VALUE AT WHICH THEY WERE INCLUDED IN THE GROSS ESTATE FOR FEDERAL ESTATE TAXATION.

Louisa Andrews, at death on March 22, 1917, owned 1100/4000ths of the net payments to be made by the Youngstown Company. She bequeathed 550/4000ths to her daughter, Mrs. Logan. The Government included these 550/4000ths of anticipated payments in the estate of Louisa Andrews at a value of $277,164.50 and levied the estate tax on that basis. Mrs. Logan received up to December 31, 1920, the last year in question, $31,767.59 of these payments, of which the Government is seeking to tax again this time under the income tax laws $21,252.84. Petitioner cannot gracefully accuse the Second Circuit of applying to this part of the case the same principles as in the rest of the case, for

its brief in the Second Circuit fails to show that any sort of distinction was made by the Government counsel between the amounts received by bequest and the amounts received as part of the purchase price of stock sold.

The anticipated payments represent a chose in action belonging to the estate. When they are reduced to possession by the legatee, the amounts simply represent payment of the bequest in cash and are expressly exempted from income tax by Section 213(b) (3) of the Revenue Act of 1918 (February 29, 1919) c. 18, 40 Stat. L. 1065.

> "Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—
> "(b) Does not include the following items, which shall be exempt from taxation under this title:
> "(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);"

The statutory provision expressly exempting bequests has been entirely overlooked both by the Government and the Sixth Circuit. To say that the bequest is recovered in installments, part of which is bequest and part of which is income, is to deny the exemption provided by law its full force and is an attempt by administrative action to impinge upon the statutory exemption. A bequest of a chose in action of $100 to A, which A collects in due course, can hardly be said to be an "income-producing contract," and that A receives $100 otherwise than by bequest. *Irwin* v. *Gavit*, 268 U. S. 161, was not directed to a case of this kind. That case turned on the principle that income does not lose its character simply because it is severed from the principal fund. The court states (p. 167):

> "* * * The money was income in the hands of the trustees, and we know of nothing in the law that prevented its being paid and received as income by the donee."

This part of the instant case is more closely analogous to the situation in *Burnet, Commissioner*, v. *Whitehouse* (decided by this Court on April 13, 1931), which involved the bequest of an annuity directed to be paid irrespective of income received. This Court held that the payments thereunder constituted a bequest and were exempt as such and explained *Irwin* v. *Gavit* as follows:

> "Irwin v. Gavit is not applicable. The bequest to Gavit was to be paid out of income from a definite fund. If that yielded nothing, he got nothing. This court concluded that the gift was of money to be derived from income and to be paid and received as income by the donee. Here the gift did not depend upon income but was a charge upon the whole estate during the life of the legatee to be satisfied like any ordinary bequest."

The payments on account of the 550/4000ths interest, therefore, were clearly payment of the bequest to Mrs. Logan.

In case the payments had been reduced to possession by the executor, they would not have been taxable as income in his hands until the payments received exceeded the value at which the anticipated payments were subjected to estate tax. *Nichols* v. *U. S.*, 64 Ct. Cls. 241; cert. denied, 277 U. S. 584. The Board of Tax Appeals has held repeatedly to the same effect and the Commissioner has acquiesced in its decisions. *McCarthy, Ex'x* v. *Commissioner*, 9 B. T. A. 525, Acq., VII-2 C. B. 26; *Hearn, Adm'x.*, v. *Commissioner*, 9 B. T. A. 1362, Acq. VII-2 C. B. 17; *Nichols, Ex'r.* v. *Commissioner*, 10 B. T. A. 919, Acq. VII-2 C. B. 29, and other cases. The Commissioner has issued rulings to the same effect. *I. T. 1383, I-2 C. B. 157; O. D. 1112, 5 C. B. 55; I. T. 1563, II-1 C. B. 49; G. C. M. 4983, VII-2 C. B. 136.*

See also *Hertzberg et al.* v. *Wisconsin Tax Commission* (1927), 215 N. W. 936, 194 Wis. 126. See a discussion of that case in *G. C. M. 8826, IX-2 C. B. 194, 197.*

The case of *U. S.* v. *Carter* (C. C. A. 5th), 19 Fed. (2d)

121 (1927), goes to the extent of indicating that even the difference between the estimated and actual value of the bequest is not income.

A distributee of the estate stands in no worse position than an executor in this respect, but rather stands in a better, for in addition he has the support of the statute expressly exempting bequests from income tax.

No injustice is done to the United States, for a Federal Estate Tax was paid on the inheritance. On the same inheritance, the Government seeks to collect an income tax, without noting that it had already collected the estate tax. The Government is contending for an analysis that would impose a double tax on the same payments. The collection of the amount inherited was not a "sale or disposition" of the bequest. Adequate provision is made when income tax is paid on the amounts received in excess of the value at which the payments were subjected to estate tax.

VII. EVEN IF THE SALE WAS A CLOSED AND COMPLETED TRANSACTION IN 1916, THE APPORTIONMENT OF EACH PAYMENT THEREAFTER INTO CAPITAL AND INCOME AS MADE BY THE BOARD OF TAX APPEALS AND THE COMMISSIONER IN EACH YEAR IS WRONG.

The Government suggests that it is not clear, in the event this is a closed and completed sale in 1916, that any part of the payments thereafter represent capital returns. This contention overlooks the fact that to obtain these payments the respondent sold her stock. That stock represents the cost of the payments. The amount to be restored is the March 1, 1913, value of that stock, since it was acquired before March 1, 1913. The *present value* at March 11, 1916, is used by the Commissioner and the Board on the theory that this was the amount "invested," and the case was so

briefed and argued below by the Government. The Bureau allowed a return on the theory that the payments were "royalties" and the return of cost thereof "depletion"; (R. 53-55); the Board's opinion followed that thought for a time and then ended by calling it "exhaustion of contract right" (R. 28). The Government is still confused as to what it is returning to the taxpayer and while suggesting that nothing should be allowed, insists that what has been allowed is enough.

If we approach the problem from the assumption made by the Government that $132,573.60 will be received each year by the former stockholders for 45 years, these payments would be analogous to annuities. The Commissioner is not in a position to answer that they are not annuities, for the validity of the Commissioner's "fair market value" depends on his argument that these payments are certain and predictable. The Board itself has recognized this in the subsequent case of *Guaranty Trust Company of New York, Executor*, v. *Commissioner*, 15 B. T. A. 20, 23, 24, in which it stated that the transfer of a leasehold estate for a promise to pay $100,000 annually to Sherry so long as he should live, was similar to the instant case.

On the Commissioner's theory, this is indistinguishable from the purchase of an annuity and consequently the same methods of determining the point at which income is derived and the amount of income in each payment, should be applied.

Up to and including the decision in *Warner* v. *Walsh* (C. C. A. 2nd), 15 Fed. (2d) 367, on November 8, 1926, the tax laws were consistently administered on the basis that before any part of the payments under annuity contracts could be considered income, the entire cost should first be restored. *I. T. 1484, I-2 C. B. 66, 67, I. T. 1363, I-1 C. B. 79; G. C. M: 1022, VI-1 C. B. 12.* Other circuit courts have reached this result even under the earlier acts. *U. S.* v. *Bolster* (C. C. A. 1st), 26 Fed. (2d) 760 (1928); *Allen* v.

Brandeis (C. C. A. 8th), 29 Fed. (2d) 363 (1928); *Continental Illinois Bank & Trust Company* v. *Commissioner* (C. C. A. 7th), 45 Fed. (2d) 345 (1930). The earlier statutes simply required the return of the premium paid without stating how it should be returned. See Section 4 of the Revenue Act of September 8, 1916; Sections 213(b) (2) of the Revenue Acts of 1918, 1921, 1924 (Appendix). In the Revenue Act of 1926 (Section 213(b)(2)), (app'x) the rule that all cost must be restored before any part is taxable was specifically enacted into law and the regulations conformed thereto. *Regs. 69, Art. 72.* The same provision was repeated in the Revenue Act of 1928 (Section 22(b) (2) (app'x), and Regs. 74 thereunder, Art. 82. The later enactment would, under these conditions, seem to be a clarification rather than a change from the earlier statutory provisions. *Oglesby Coal Co.* v. *Commissioner* (C. C. A. 7th), 46 Fed. (2d) 617, 618.

Therefore, from 1916 to 1928, the Treasury Department had consistently applied the principle used in *Warner* v. *Walsh.* In that period of time, a total of eight revenue acts were enacted by Congress, and in no one of these acts was the rule with respect to annuities as heretofore enforced by the Commissioner of Internal Revenue and sanctioned by the courts, changed in any manner. It received specific statutory approval in the Revenue Acts of 1926 and 1928. In *Brewster* v. *Gage*, 280 U. S. 327, 337; 74 L. Ed. 457, 463, this Court stated:

> "The substantial re-enactment in later acts of the provision theretofore construed by the department is persuasive evidence of legislative approval of the regulation (citing cases) * * *."

It is well established that administrative interpretation, long established, is entitled to considerable weight in the construction of statutes. *Downes* v. *Bidwell*, 182 U. S. 244; *St. Paul, Minneapolis Railway Co.* v. *Phelps*, 137 U. S. 528.

The only dissent to this current of authority is that of the Board of Tax Appeals in *Klein* v. *Commissioner*, 6 B. T. A. 617, which in point of time followed the *Warner* case but preceded the others. The case held that each payment represented in part income in the form of interest and part return of cost or capital. The earlier payments contain a larger proportion of capital. As the payments are made the proportion of capital returned decreases and the amount of taxable income increases in accordance with annuity tables. This very method was first applied to the instant case in the first controversy to come before the Board, *Bruce* v. *Commissioner*, 5 B. T. A. 300, 308:

> "The payments to all the stockholders were estimated by the Commissioner to be $132,573.60 annually for 45 years. These payments were reduced to present worth, using a discount of 6 per cent on future payments with a 4 per cent return on sinking fund. It is evident that the present worth of the payment to be received at the end of the first year differs substantially from the present worth of the payment to be received 45 years in the future. It is further evident that the present worth of all the payments is the sum of the present worth of each annual payment, proper adjustment for the sinking fund being made. In determining what portion of the payment represented a return of the 1916 value, the Commissioner has made the allocation between principal and gain as if the present value in 1916 of each of the annual payments to be received was exactly the same. The proper manner in which to determine what portion of the payment is principal is to split up the total 1916 present worth into its component parts and to treat the present value of the first year's payment as a return of principal upon the first 1,841,300 tons (the estimated annual production) mined, the present value of the second year's payment as a return of principal upon the second 1,841,300 tons mined, and similarly each year until the mine becomes exhausted, or the principal is all returned."

The same principle that the earlier payments contain a larger proportion of income was applied in *Ruth Law Company* v. *Commissioner* (C. C. A. 8th), 26 Fed. (2d) 30, and *Kosmerl* v. *Commissioner* (C. C. A. 7th), 25 Fed. (2d) 87, heretofore relied upon by the Government and the Board.

In the instant case, the Board overruled its prior decision in the *Bruce* case on this point and adopted the Commissioner's method. Two members, following the prior decision, dissented.

The only Court decision applying the method used by the Commissioner is *Eldredge* v. *U. S.* (C. C. A. 6th), 31 Fed. (2d) 924. Judge Mack wrote the opinion in both the *Warner* case in the Second Circuit and the opinion in the *Eldredge* case in the Sixth Circuit. He tried to distinguish the *Eldredge* case from the other Circuit Court decisions by stating that the point relating to return of capital was not argued in those cases. Though not argued, the point was certainly necessary to a decision, and though somewhat inartistically, it was presented in the Government's brief both in *U. S.* v. *Bolster* (C. C. A. 1st), and in *Allen* v. *Brandeis* (C. C. A. 8th):

> "The purchase of an annuity involves the payment of such a sum as will be exhausted at the end of a given period if it and its earnings are paid over to the purchaser in stated annual or other installments. Such installments are composed in part of a portion of the principal sum paid and in part of the earnings during the period of the entire remaining sum" (Brandeis brief, p. 13; Bolster brief, p. 8).

The Government did not attempt to take any of these cases up though the *Klein* opinion was outstanding. In fact, as late as 1929, and more than two years after the *Klein* case, the Commissioner published these decisions as authority for administrative purposes. T. D. 4256-7-8; VIII-1 C. B. 243, 246, 247.

Be that as it may, the *Eldredge* case was founded on the

erroneous assumption by Judge Mack that Hoskold's table gives a single value and that it is impracticable to determine the present value of each assumed payment, and so held it was not necessary to choose between *Warner* v. *Walsh* and the *Klein* rule (p. 929):

> "In the instant case the witnesses as to 1913 capital value have relied upon Hoskold's Formula and obtained a single value of the whole series of annual payments; there is no determination of the March 1, 1913 value of each annual payment. * * *"

Hoskold's formula gives a single present value for a series of assumed annual payments but that value is precisely the sum total of the present value of each payment. The table is simply a short cut to the result of a laborious computation. The skein is just as readily unwound as it is wound. The first Board decision so held and the dissenting members followed it. The annuity tables will give the present value of each payment so that the method is not only practicable but fair, since the apportionment corresponds to the interest element. The risk element is covered by the rate of interest selected in making the discount. The method used in the *Eldredge* case is the rule used in determining depletion of mines and has no application to assumed annual payments which do not depend on exhaustion of ore reserves.

In *Commissioner* v. *John C. Moore Corp.* (C. C. A. 2nd), 42 Fed. (2d) 186 (1930), Judge Mack again reviewed all the various rules and suggested a fourth rule. None of them was held material to the decision, however, and so no choice was made. In a case such as the present, the element of uncertainty both as to the amount and duration of the payments not only makes the rule of *Warner* v. *Walsh* the simpler but also the only reliable rule. In the event that rule is not applied, certainly the principle of apportionment used in the *Klein*, *Ruth Iron* and the first Board decision in

the *Bruce* case should be applied rather than the erroneously founded rule of the *Eldredge* case.

CONCLUSION.

Mrs. Logan derived no taxable gain in any year, since the March 1, 1913, value of the stock sold by her had not been restored during the years in question.

The payments received by bequest under her mother's will are specifically exempted by law from income tax, and furthermore, were taxed as capital to the estate, and cannot be again taxed as income to Mrs. Logan, at least until the amount received exceeds the value at the date of death.

The foregoing points should suffice to dispose of this matter and result in an affirmance of the decision of the Second Circuit.

The Government's argument (Petitioner's Brief, p. 24) that this postpones the profit, and that death may intervene, lacks merit, in that, if no profit is derived before death, there should be no tax for a supposed gain. Furthermore, the estimated value of the payments, as in the case of respondent's mother, is taxed by the Government as part of the decedent's estate. The possibility of death before a profit is derived is rather an argument against taxing a citizen on the prospect that he will live and derive a profit.

The alleged liability for taxes asserted against respondent is based not upon cash payments received, although she made her returns upon the basis of cash receipts and disbursements, but upon a statistical computation based as we have shown upon assumptions and prophecies, as to what will happen during a period, extending into the future for forty-five years, all of which the court below rejected.

If the Government's position is accepted by this Court, the payments received on the Government's theory would correspond to annuity payments for forty-five years, acquired at a cost measured by the March 1, 1913, value of the

stock. The cost or base of the payments should be restored before any part constitutes taxable income. This was the administrative and judicial rule up to the *Klein* case. If each payment is held to represent part interest and part capital, then certainly, Mrs. Logan should be allowed to make the division on the same basis as the present value was determined, in accordance with the opinion of the dissenting members of the Board.

The principle laid down by the Circuit Court of Appeals has the great merit of simplicity. It does no injustice to the Government, or the taxpayer. It is not necessary to resolve any of the other and abstruse questions, if respondent is right in her contention that no taxable gain is derived by her, no matter what form the legal analysis of the transaction takes, until she has, in fact and not on paper, recouped the March 1, 1913, value of the stock sold by her, and the value at the date of her mother's death of the right to the payments thereunder.

In view of the foregoing, it is respectfully submitted, that the judgment of the Circuit Court of Appeals for the Second Circuit should be affirmed.

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APPENDIX.

Section 4 of the Revenue Act of 1916 (Sept. 8, 1916) (c. 463, 39 Stat. L. 758):

"Sec. 4. The following income shall be exempt from the provisions of this title:

"* * * The amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon the surrender of the contract; * * *."

Section 202(a) (1) of the Revenue Act of 1918 (Feb. 24, 1919) (c. 18, 40 Stat. L. 1057):

"Sec. 202(a). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and"

Section 213(b) (2) of the Revenue Act of 1918 (Feb. 29, 1919) (c. 18, 40 Stat. L. 1065), and Section 213(b) (2) of the Revenue Act of 1921 (Nov. 23, 1921) (c. 136, 42 Stat. L. 238):

"Sec. 213. That for the purposes of this title (except as otherwise provided in Section 233) the term 'gross income'—

"(b) Does not include the following items, which shall be exempt from taxation under this title:

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;"

Section 213(b) (2) of the Revenue Act of 1924 (June 2, 1924) (c. 234, 43 Stat. L. 267-8):

"Sec. 213(b). The term 'gross income' does not include the following items, which shall be exempt from taxation under this title:

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;"

Section 213(b) (2) of the Revenue Act of 1926 (Feb. 26, 1926) (c. 27, 44 Stat. L. 23-4):

"Sec. 213(b). The term 'gross income' does not include the following items, which shall be exempt from taxation under this title:

"(2) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *"

Section 22(b) (2) of the Revenue Act of 1928 (May 29, 1928) (c. 852, 45 Stat. L. 797-8):

"Sec. 22(b). Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

"(2) Annuities, etc.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *"

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 522

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

JULIA ANDREWS BRUCE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JULIA ANDREWS BRUCE,
Respondent.

No. 522

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

PRELIMINARY STATEMENT.

The questions presented by this case and by No. 521 are identical and the respondent fully concurs in the argument contained in the brief for the respondent in No. 521. This brief is therefore confined to the presentation of additional argument and avoids repetition in so far as possible.

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals (R. 87-88) is reported in 42 F. (2d) 197.

In all other respects the statements in the brief for the respondent in No. 521 as to the opinions below are equally applicable to this case.

JURISDICTION

The basis for jurisdiction of this Court is correctly stated in the brief for the petitioner.

QUESTIONS PRESENTED

The respondent concurs in the statement of the questions presented contained in the brief for the respondent in No. 521 except that the income tax asserted against the respondent in this case is for the years 1918 and 1919 only.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix to this brief.

STATEMENT OF THE CASE

This case arises under the Revenue Act of 1918 (c.18, 40 Stat. 1057) and concerns the determination of the income tax due from the respondent for the years 1918 and 1919.

The facts are as follows:

In 1916 the respondent sold to Youngstown Sheet & Tube Company 350 shares of the capital stock of Andrews & Hitchcock Iron Company which she had acquired prior to March 1, 1913. At the same time all the other stockholders of Andrews & Hitchcock Iron Company, including the respondent's mother, Louisa Andrews, sold their shares to Youngstown Sheet & Tube Company. The aggregate number of shares outstanding and so sold was 4,000 (R. 8-9).

The purchase price was fixed by an agreement made March 11, 1916 (R. 40-42) under which Youngstown Sheet & Tube Company agreed to purchase the entire 4,000 shares and to pay therefor $2,200,000 in cash in 1916 and "as the balance of said purchase price" (R. 41) a further sum, indeterminate both as to the aggregate amount thereof and as to the time of payment. This indeterminate further sum was, pursuant to the agreement, to be computed and paid from year to year thereafter. The payment to be made each year was to be an amount equal to 60¢ per ton for each ton of iron ore to which Youngstown Sheet & Tube Company might during the year become entitled by virtue of its ownership of the capital stock of Andrews & Hitchcock Iron Company which in turn owned 12% of the capital stock of Mahoning Ore & Steel Company and was entitled by virtue of a contract between the stockholders of the latter company (R. 43-45) to receive, at cost, 12% of the output of iron ore mined annually by the latter company.

The respondent was entitled in respect of the 350 shares of stock sold by her in 1916 to receive 350/4,000ths of the purchase price.

On March 22, 1917 Louisa Andrews died and the respondent acquired by bequest from her the right to receive 550/4,000ths of the then unpaid portion of the purchase price (R. 11). The value of this right at the date of Louisa Andrews' death was fixed by the Commissioner of Internal Revenue for the purposes of the Federal estate tax at $277,164.50 (R. 11).

During each of the years 1918 and 1919 the respondent received payments both on account of the purchase price of the shares sold by her and on account of the shares sold by her mother (R. 11). The sum of the payments received by the respondent down to and including the year 1919 on account of the purchase price of the 350 shares sold by her in 1916 was less than the value on March 1, 1913 of those shares (R. 11). The sum of the payments received by the respondent down to and including the year 1919 on account of the purchase price of the 550 shares sold by her mother was less than $277,164.50 (R. 12).

The Commissioner of Internal Revenue determined that the value at March 11, 1916 of the portion of the purchase price of the entire 4,000 shares of stock of Andrews & Hitchcock Iron Company, which was to be paid from year to year subsequent to 1916, was $1,942,111.46 (R. 13). This determination was based upon the following assumptions:

> That Mahoning Ore & Steel Company had ore reserves on March 11, 1916 of 82,858,535 tons;
>
> That all of this ore would be mined;
>
> That 12% thereof would be delivered to Youngstown Sheet & Tube Company;

That, upon the foregoing assumptions, all the vendors of the stock of Andrews & Hitchcock Iron Company, and their successors in interest, would receive the sum of $5,965,814.52;

That this sum of $5,965,814.52 would be received in equal annual instalments during a period of forty-five years; and

That in order to determine the value of the unpaid portion of the purchase price, such assumed equal annual instalments should be discounted at 6%, with provision for a sinking fund at 4% (R. 13).

Upon the basis of the value thus fixed, the Commissioner determined that of every dollar received by the respondent during the years 1918 and 1919 on account of the purchase price of the 350 shares sold by her in 1916, $0.32554 represented a return of capital and $0.67446 constituted taxable income (R. 5). The Commissioner arrived at this result by dividing the sum of $5,965,814.52 by $1,942,111.46. Upon the same principles the Commissioner determined that of every dollar received by the respondent during the years 1918 and 1919 on account of the purchase price of 550 shares sold by her mother, $0.33099 represented a return of capital and $0.66901 constituted taxable income (R. 5).

The estimate of the ore reserves of Mahoning Ore & Steel Company was based upon the content of only approximately 620 acres out of approximately 1,000 acres of mineral land leased by the company (R. 12, 13). The amount of tonnage to be produced annually by the

Mahoning mine was left to the determination of the board of directors of that company (R. 12). In the proceeding before the Board of Tax Appeals it was stipulated that a difference of opinion existed between engineers and experts qualified by education and training in the iron mining industry employed by the Mahoning Ore & Steel Company, on the one hand, and by the Commissioner, on the other, as to the estimated annual production of the Mahoning mine and its life as of March 11, 1916 (R. 38-39); and that since fixing the deficiency in this case the Commissioner in a proceeding in which the depletion rate for the Mahoning Ore & Steel Company was changed, based upon data furnished by the company and the opinions of duly qualified engineers and experts employed by him, found that the life of said mine was forty years from March 1, 1913, and that the estimated ore reserves of said mine on March 1, 1913 were 88,561,533 tons (R. 39).

The respondent kept no books and her returns for Federal income tax for each of the years from 1916 to 1919, inclusive, were made on the basis of cash receipts and disbursements (R. 12).

The Board, two members dissenting in part (R. 25-26), sustained the determination of the Commissioner (R. 7-25). The Circuit Court of Appeals unanimously reversed the order of the Board of Tax Appeals and held that no part of the sums received by the respondent during the years 1918 and 1919 constituted taxable income (R. 87-88). In reaching this result, the court, as appears from its opinion in *Logan* v. *Commissioner of Internal Revenue*, 42 F. (2d) 193, discountenanced the valuation made by the Commissioner as at

March 11, 1916, and (p. 197) held that no taxable income was received until there had been a return to the taxpayer of the value as of March 1, 1913 of the shares sold by her and of the value at the time of her mother's death of the interest in the unpaid purchase price inherited by her from her mother.

SUMMARY OF ARGUMENT

The argument which the respondent in this case proposes to make is additional to and not repetitive of that contained in the brief for the respondent in No. 521.

The respondent concurs in and has nothing to add to the argument set forth in Points I to VI, inclusive, of the brief for the respondent in No. 521 which may be summarized as follows:

1. The unpaid portion of the purchase price of the stock sold by the respondent in 1916 had no fair market value at March 11, 1916 and was not the equivalent of cash at that date. The sale of stock by the respondent on that date did not constitute an exchange of property or a closed transaction such as would establish a new "basis" for the determination of future gain or loss. The respondent therefore received no taxable income until the aggregate amount received by her exceeded the value of the stock at March 1, 1913.

2. As to the unpaid portion of the purchase price bequeathed to the respondent, she received no taxable in-

come until the aggregate amount received by her exceeded the value at which the property bequeathed was included in the gross estate for Federal estate taxation.

These propositions, if established, are of themselves sufficient to dispose of the case, but it is also true that it would seem unnecessary for this Court to pass upon the issues involved in the foregoing propositions if, as the respondent contends, no portion of the payments received by her may be subjected to tax as income until she has recovered her entire capital, whether this capital be represented by the value at March 1, 1913 of the shares sold by her, or by the value fixed by the Commissioner at March 11, 1916 upon the unpaid portion of the purchase price, or by the value fixed by the Commissioner at March 22, 1917 upon the bequest received from her mother.

The points which the respondent proposes to argue are the following:

I. The payments received by the respondent in 1918 and 1919 constituted a return of capital, no portion of which is taxable as income and did not constitute gross income in respect of which an allowance as a deduction for exhaustion or depletion might or should be made.

A. "Gross income" and "gross receipts" are not synonymous. Only the excess of gross receipts over the capital recovered constitutes gross income.

B. Where there is uncertainty as to the ultimate recovery of capital, the proceeds of the sale, conversion or other disposition of property should be applied in reduction of the "basis" prescribed by law until the entire amount of capital has been recouped.

II. Even if the payments received by the respondent during 1918 and 1919 constituted in part return of capital and in part gross income, the segregation of capital from income should be made on the same basis and by the same method as those adopted by the petitioner in computing the value of the respondent's rights to receive such payments.

For the purposes of this argument the term "capital" is used as descriptive of amounts which are exempt from taxation as income as a matter of fundamental law, or because of express statutory exemption such as the value at March 1, 1913 of property acquired prior thereto (Section 202(a) (1) of the Revenue Act of 1918) and the value of property received by bequest or inheritance (Section 213(b) (3) of the Revenue Act of 1918).

POINT I.

THE PAYMENTS RECEIVED BY THE RESPONDENT IN 1918 AND 1919 CONSTITUTED A RETURN OF CAPITAL, NO PORTION OF WHICH IS TAXABLE AS INCOME AND DID NOT CONSTITUTE GROSS INCOME IN RESPECT OF WHICH AN ALLOWANCE AS A DEDUCTION FOR EXHAUSTION OR DEPLETION MIGHT OR SHOULD BE MADE.

A.

"Gross income" and "gross receipts" are not synonymous. Only the excess of gross receipts over the capital recovered constitutes gross income.

Recognition of the basic distinction between "gross income", upon which Congress may, if it will, under the Sixteenth Amendment, charge the tax without allowing deductions, and "gross receipts", out of which the portion, if any, representing a return of the capital value of property sold, converted into other property or cash, or otherwise disposed of, must first be set apart before any "gross income" can arise, is essential to a clear understanding of the issue presented.

Failure to recognize the importance and controlling effect of this distinction has led the Commissioner and the Board of Tax Appeals astray in the instant case and largely accounts for such confusion and apparent conflict as exists in the decided cases in which questions similar to that here presented have arisen. Especially has

the superficial resemblance of the problem here presented to that arising in connection with the allowance of a reasonable deduction for depletion in the case of mines, led to unsound reasoning and incorrect conclusions. In fact, it is clear that this confusion lies at the root of the error in the Commissioner's determination in this matter, since it is known that the determination of the respondent's taxable income was, in the first instance, referred for consideration and computation to the Engineering Division of the Income Tax Unit, and the case has been treated throughout (except by the court below) as a case involving depletion of mining properties.

Concededly, Congress may allow or refuse to allow or may limit deductions from "gross income", as it may see fit. *New Creek Co. v. Lederer* (C. C. A. 3d), 295 Fed. 433. It may, for instance, as it has done, provide that reasonable allowances shall be made for exhaustion, depreciation, compensation paid, etc. But there is a vast difference between a *reasonable* deduction from "gross income", which Congress may allow or refrain from allowing, and the constitutional and statutory distinctions between income and return of capital. In the latter case, which is the present case, it is not sufficient that the determination be *merely reasonable*. It must be as exact as the particular facts admit of. If the question be one of deductions from "gross income", it is sufficient if it be concluded that the allowance made is reasonable in the light of all the circumstances. If the question concerns the distinction between return of capital and "gross income", the most meticulous care must be observed so as to

avoid imposing the tax upon capital. In such cases the least that is required is that the amount, if any, to be charged as income be determined with the utmost accuracy that the available facts make possible. Doubt in such cases must, on well-established principles, be resolved in favor of the taxpayer. *American Net & Twine Co.* v. *Worthington*, 141 U. S. 468, 474; *Benziger* v. *United States*, 192 U. S. 38, 55; *Gould* v. *Gould*, 245 U. S. 151; *Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S. 346; *Russell* v. *United States*, 278 U. S. 181. Where no rule can be applied which will assure to the taxpayer the recovery of his capital by the time that the entire proceeds of the sale, conversion or other disposition of property have been received, as in the case of liquidating dividends, the only safe procedure is to apply "gross receipts" in reduction of capital until capital has been recovered in its entirety, and thereafter to charge all further "gross receipts" as "gross income" subject to tax.

The second point urged in the brief for the petitioner is that the payments received by the respondent "constituted gross income and a sufficient allowance for exhaustion has been made" (p. 21). It is even suggested that the entire amount of the payments should, or might have been, taxed as gross income and no allowance made for deductions (pp. 8, 21, 22). As above indicated, there is a fundamental fallacy in this approach to the question. The fallacy lies in the proposition advanced by the petitioner that where no sale is involved "annual receipts which represent the earnings of property are taxable in their entirety unless Congress makes an allowance for

exhaustion of the property" (pp. 21-22). This proposition begs the question and assumes that the amounts received by the respondent constituted earnings of property rather than the gross proceeds of the conversion of property into cash. The reasoning upon which the petitioner proceeds closely resembles that relied upon by the Solicitor General in his argument in *Doyle* v. *Mitchell*, 247 U. S. 179 which was to the effect that "gross income" is equivalent to "gross receipts", that the entire proceeds of a conversion of capital assets should be treated as gross income, and that by deducting the mere cost of assets, net income is arrived at. In its opinion in that case this Court expressly discountenanced this proposition and said (p. 184):

> "Yet it is plain, we think, that by the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income. Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports, as used here, something entirely distinct from principal or capital. . . ."

The petitioner seeks to confine the effect of *Doyle* v. *Mitchell*, (*supra*) to cases involving the sale of property and in support of this novel theory cites *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U. S. 126; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103. Of the cases cited this Court in *Doyle* v. *Mitchell*, (*supra*) said with respect to the *Sargent Land Company* case and the *Goldfield Consolidated*

Mines Company case, which were the only cases cited which had at that date been decided (p. 188):

> "There is only a superficial analogy between this case and the case of an allowance claimed for depreciation of a mining property through the removal of minerals, since we have held that owing to the peculiar nature of mining property its partial exhaustion attributable to the removal of ores cannot be regarded as depreciation within the meaning of the act."

Although the Board of Tax Appeals in its opinion in this case fell into the same error and repeatedly referred to the payments received by the respondent as "royalties" in respect of which an allowance for depletion or depreciation should be made (R. 24) it is evident that the payments did not constitute royalties or the earnings of property but constituted the proceeds of the sale of stock or the conversion of those proceeds into cash. Both the petitioner and the Board of Tax Appeals have gone astray. It was the Board's opinion that

> "* * * a proper solution to the question of what part of the royalties received constituted taxable income lies in considering the entire amount of royalties received in a given year as includable in gross income and then in permitting a reasonable deduction therefrom in each year for the exhaustion of the contract." (R. 21)

and it rested its decision upon the erroneous conclusion that Section 213(a) of the Revenue Act of 1918 "would require all royalties received to be included in the gross income" of the respondent (R. 22).

It should be clear that we are not concerned here with "gross income" as defined in Section 213 of the Revenue Act of 1918 and deductions from gross income as authorized by Section 214 of the Act. We are concerned with the distinction between capital or principal and gross income. This is true whether the amount to be recovered by the respondent free of tax be the value of her stock at March 1, 1913 or the value of the unpaid purchase price at March 11, 1916 or the value at March 22, 1917 of the right inherited from her mother. This was the view taken by the court below in *Logan* v. *Commissioner*, (*supra*), (p. 196):

> "The Commissioner may not create income by spelling out paper profits with all the attending uncertainties which exist here and which might prevent the return of capital. The statute and the regulation referring to depletion of the mines, we think, have no application to this petitioner."

The question is whether any portion of the amounts received constituted gross income; not whether any deduction may be allowed from the gross amount thereof upon the basis of any of the specific provisions for deductions to be found in Section 214 of the Revenue Act of 1918. The petitioner in his brief (p. 22) correctly points out that the respondent had no interest in the mine nor such a relation to the mine as would entitle her to the statutory allowance for depletion and further urges that the allowance of a deduction for exhaustion which

the Board of Tax Appeals held that the respondent was entitled to was a liberal construction of the statute. But the respondent does not rely upon the statutory deductions in support of her contention that no portion of the payments constituted taxable income. Her contention is that if any portion of the amounts received constituted income, that portion was "gross income" and the remainder constituted a return of capital instead of a deduction from "gross income".

The amounts received by the respondent in 1918 and 1919 did not, as suggested by the petitioner constitute "annual receipts which represent the earnings of property" (pp. 21-22). Whether they be viewed as proceeds of the sale of personal property or as proceeds of the conversion into cash of the right to receive the payments, the result is the same. In either case the taxpayer parted with property and received cash in lieu thereof and the capital value of the thing with which she parted must be restored to her before any gain subject to tax can be realized. The situation is precisely that contemplated by this Court in *Doyle* v. *Mitchell*, (*supra*) when it said (p. 185):

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

B

Where there is uncertainty as to the ultimate recovery of capital, the proceeds of the sale, conversion or other disposition of property should be applied in reduction of the "basis" prescribed by law until the entire amount of capital has been recouped.

Once it is recognized that the law applicable to the question presented here is not that which deals with the reasonableness of allowances authorized by Congress, but that which deals with the power or intent of Congress to tax capital, it becomes evident that the rule adopted should be one which will carve out of gross receipts with the greatest nicety and subject to the tax only that portion, if any, which clearly and beyond question constitutes income. The mass of capital must be left intact at any cost. If the cleavage cannot be made with accuracy, it should be made in such manner that no portion of capital will adhere to the portion taxed as income. It is of much less consequence from the standpoints of constitutionality and of the power and intent of Congress to levy the tax if shreds of income are left imbedded in the mass of capital and thus not presently taxed. For if the taxpayer eventually recoups his capital all further receipts will fall in for taxation, but if he fails to recoup his capital, the final result will be that capital has been taxed, however unintentionally. Such a result would be in some instances repugnant to the provisions of the Federal Constitution, and in every instance contrary to the intent of the Revenue Acts, *Lucas* v. *Alexander*, 279 U. S. 573.

If then the circumstances are such that there is no certainty that capital will be recouped, all receipts should be applied in reduction of cost until cost has been recovered. This has been the generally applied rule and it is the rule which should govern in the present case. There is no certainty that the respondent will receive her capital, nor is there any method by which the proportion of income, if any, included in each payment can be determined with precision. The conception of the Commissioner that each payment received by the respondent contains a fixed percentage of income is certainly far from the truth, and his method of apportioning can only be justified upon the basis that an apportionment *must* be made, and that any apportionment which may appear reasonable is sufficient.

The suggestion of the petitioner (Brief, p. 24) that to permit the respondent to recover her capital before any taxable gain is recognized would unduly postpone the receipt of taxable income and that if the respondent should die in the meantime a further postponement of the receipt of taxable income from the property would occur with the possible result that the Government might collect no income tax upon any of the payments is entirely beside the point. It might equally well be urged that the tax should be levied upon unrealized increment in the value of property because by passing from one person to another as the result of death such unrealized appreciation escapes taxation through becoming exempt in the hands of the person inheriting the property. The argument of the Government amounts to this: inasmuch as the postponement of taxation until the taxpayer has

received her capital may result in no gain to the Treasury, it is necessary to tax some portion of the amounts received immediately, altogether irrespective of the fact that the respondent in this instance has no certainty, owing to the many contingencies involved, of ever receiving the entire amount of her capital. The suggestion is that the taxpayer must take the chance of recovering her capital while the Government must not run any hazard of failing to collect a tax through the chance of her dying before she receives income.

It is conceded that the respondent had not, up to December 31, 1919, received in the aggregate amounts equal to the value at March 1, 1913 of the stock sold by her in 1916 (R. 11) or to the value at the date of the death of her mother of the unpaid purchase price bequeathed to her (R. 12) and it is clear from the record that she had not, up to December 31, 1919, received the value placed upon her interest in the unpaid purchase price as of March 11, 1916 by the Commissioner. The value fixed by him on her interest at March 11, 1916 was $169,934.73 (R. 5) and the amount received by her up to December 31, 1919 (exclusive of her share of the original cash payment) was $42,203.70 (R. 11) Section 202(a) (1) of the Revenue Act of 1918 excludes from gross income the value of property acquired before March 1, 1913. Section 202(a) (2) of the Revenue Act of 1918 excludes from gross income the cost of property acquired on or after March 1, 1913. Section 213(b) (3) of the Act excludes from gross income the value of property received by bequest. There is no theory upon which it can be maintained that the respondent has

received any amount in excess of her capital nor is there any certainty that she will recoup her capital out of payments to be made in the future.

In this respect the present case differs entirely from *Ruth Iron Co.* v. *Commissioner* (C. C. A. 8th) 26 F. (2d) 30; *Kosmerl* v. *Commissioner of Internal Revenue* (C. C. A. 7th) 25 F. (2d) 87, and *Platt* v. *Bowers* (S. D. N. Y.) 13 F. (2d) 951. In each of these cases the recovery of the taxpayer's capital was assured and the portion of each payment representing compensation for deferred payment and therefore income, was readily determinable. There were no contingencies as to the amounts to be received and as to the time of payment and no hazards as to the ultimate recovery of the capital, such as were recognized to exist in this case by the court below. The only cases which may be cited in which such uncertainties as to recovery of capital existed are *Eldredge* v. *U. S.*, (C. C. A. 6th) 31 F. (2d) 924 hereafter discussed and *Hitchcock* v. *Commissioner of Internal Revenue* (C. C. A. 6th) 44 F. (2d) 756 which involves the same facts as the present case and was disposed of by the Circuit Court for the Sixth Circuit upon the authority of the *Eldredge* case.

In support of the decision of the court below may be cited *Warner* v. *Walsh*, (C. C. A. 2nd) 15 F. (2d) 367; *United States* v. *Bolster*, (C. C. A. 1st) 26 F. (2d) 760; *Allen* v. *Brandeis*, (C. C. A. 8th) 29 F. (2d) 363; and *Continental Illinois Bank & Trust Company* v. *Blair*, (C. C. A. 7th) 45 F. (2d) 345 (1930).

Cases in which similar questions have been before the courts may be roughly classified into four groups:

(1) Those cases in which the question presented was distinctly confined to the reasonableness of a particular allowance for a deduction authorized by law. *Reinecke* v. *Spalding*, 280 U. S. 227; *Rosenberger* v. *McCaughn*, (C. C. A. 3d) 55 F. (2d) 699; *New Creek Co.* v. *Lederer* (*supra*).

(2) Those cases in which there was certainty as to the ultimate recovery of the capital sum involved and data was available for a precise apportionment of receipts between capital and income. *Ruth Iron Company* v. *Commissioner of Internal Revenue* (*supra*); *Kosmerl* v. *Commissioner of Internal Revenue* (*supra*); *Platt* v. *Bowers* (*supra*).

(3) Those cases in which there was uncertainty as to the ultimate recovery of capital and amounts received were applied in reduction of the statutory basis until capital had been recouped. *Warner* v. *Walsh* (*supra*); *United States* v. *Bolster* (*supra*); *Allen* v. *Brandeis* (*supra*); *Continental Illinois Bank & Trust Company* v. *Blair* (*supra*).

(4) Those cases in which it was incorrectly assumed that there was certainty as to the ultimate recovery of capital with the result that unsound results were reached in the decisions. *Eldredge* v. *United States* (*supra*); *Hitchcock* v. *Commissioner of Internal Revenue* (*supra*); *Florence L. Klein* v. *Commissioner*, 6 B. T. A. 617.

Reinecke v. *Spalding* (*supra*), related solely to the reasonable allowance to be made for depletion under Sec-

tion 214(a) (10) of the Revenue Act of 1918 to a lessor of mining property. In that case the question was whether the allowance made by the Commissioner was reasonable, and this Court held that the taxpayer had failed to prove it unreasonable.

Rosenberger v. *McCaughn* (*supra*), was a case in which it was held that the amounts received were rent or royalties and not deferred payments of purchase price, so that in sustaining the Commissioner's determination the court was in fact passing upon the reasonableness of an allowance for depletion as a deduction and not upon the question of what portion of deferred payments constituted gross income as distinguished from return of capital.

New Creek Company v. *Lederer* (*supra*), was a case in which the court held that the Regulations prescribed by the Secretary of the Treasury for the enforcement of the allowance for depletion under the provisions of the Revenue Act of 1916 were not unreasonable. No question of an apportionment of gross receipts between capital and income was before the court.

The *Ruth* and *Kosmerl* cases, both affirming the decision of the Board of Tax Appeals in *Ruth Iron Co.* v. *Commissioner,* 4 B. T. A. 1151, involve the same facts. In those cases the taxpayers sold mining property for forty-one equal annual payments evidenced by non-interest bearing promissory notes secured by mortgage. The number of tons in the mine was agreed to between buyer and seller and the total purchase price computed at 35 cents per ton was definitely fixed. Both the Board and the Circuit Court held that the difference between the discounted value of each note on March 1, 1913 and the

face value thereof was income at the date of payment of each note. The only element of uncertainty involved was the rate of interest used in computing the amount of the discount which was fixed by the Commissioner at 5% compounded annually as compared with 6% compounded annually with a provision for a sinking fund of 4% in the instant case.

Platt v. *Bowers* (*supra*), involved an agreement to pay the taxpayer $10,000 a year for fifteen years and the court held that (p. 952):

> "The amount of the discount which may be regarded as income is therefore susceptible to mathematical calculation at the legal interest rate."

The *Klein* case (*supra*), must be considered with the cases of *Warner* v. *Walsh* (*supra*), *United States* v. *Bolster* (*supra*), *Allen* v. *Brandeis* (*supra*), and *Continental Illinois Bank & Trust Company* v. *Blair* (*supra*), since all of these cases involved annuities. In the four cases last mentioned, which reflect the views of four different Circuit Courts, it was held that no taxable income was received by the annuitant until the purchase price of the annuity had been recovered. The Board of Tax Appeals, after the decision in *Warner* v. *Walsh* (*supra*), but before the decisions in the other cases cited, refused to follow *Warner* v. *Walsh* and held that the entire cost need not be returned before there was taxable gain, but that each payment was to be considered partly a return of cost and partly income. The measure of the gain derived from each payment was held by the Board to be the difference between the present worth of each

payment and the amount received. This method of determining the amount of income included in each payment is consistent with *Ruth Iron Co.* v. *Commissioner* (*supra*), but it is submitted that the conclusion in the *Klein* case was reached on the basis of false premises and analogies. It may be conceded that where there is certainty as to the ultimate recovery of capital, as in the *Ruth* and *Kosmerl* cases, some portion of each annual instalment may properly be treated as income but the Board apparently based its decision on the false assumption that a life annuitant was certain to recover his investment and in its opinion erroneously cited as analogous cases the ascertainment and recognition of gain upon the sale of lots in a subdivided tract of land and upon the sale at retail of goods purchased in bulk.

The Board's statement of the way in which present value of life annuities is arrived at and its rule for determining the taxable income included in successive instalments of an annuity are both founded on a misconception of actuarial methods. The value of a life annuity on the basis of a given age and an assumed interest rate can be determined from actuarial tables, and a value so ascertained is a proper basis for valuation because annuities and reversions are commonly bought, sold and granted upon the basis thereof. But such tables do not form a proper basis for determining the profit derived from a single annuity for the very simple reason that the tables are based on the average experience in thousands of cases, whereas taxes are levied on the actually realized experience of the taxpayer and not upon the average experience of thousands of persons of whom he is but one.

When an individual acquires a single annuity at its present value, it is impossible to say whether he will make a profit or loss until either the annuity terminates or he has recovered the principal of his investment. The Board of Tax Appeals would tax the purchaser of an annuity on a life aged 60 upon the first instalment received, on the assumption that his experience would be exactly the average of all holders of like annuities; but the tables show that more than 3% of the annuitants will die in the second year, so that more than 3% of those whom the Board would tax as having received a profit would within a year be proved to have sustained a large loss, and the same condition would exist for several more years.

The failure of the Board to recognize the uncertainty as to the recovery of his investment by a single annuitant and its failure to recognize that in the case of land or goods, where a part of the cost is allocated to the tract or portion sold, the unsold property remains as a basis for the realization of future gain or loss, whereas in the case of annuity payments there is always the possibility that the annuitant may die and the expectation of future payments out of which the investment may be recouped be partly or wholly frustrated, destroy the value of the *Klein* case as an authority.

In the present case the nature of the risks and contingencies involved differ from those involved in the case of life annuities in which the amount of the annual payments is certain but their duration uncertain. In this case both the amount and duration of the payments are uncertain, but the element of uncertainty which forms the

basis of the rule in *Warner* v. *Walsh* (*supra*), exists equally in both cases as was recognized by the court below in reversing the Board of Tax Appeals. It is worthy of note that the rule of *Warner* v. *Walsh* was that consistently followed by the Treasury Department prior to the decision in the *Klein* case and that this rule was enacted as law in the Revenue Act of 1926, Section 213(b) (2) c. 19, 44 Stat. 1974 and was reenacted as Section 22(b) (2) c. 852, 45 Stat. 791 of the Revenue Act of 1928.

Except as the Board's decision in the *Klein* case may be regarded as an authority, *Eldredge* v. *United States* (*supra*) and *Hitchcock* v. *Commissioner* (*supra*) which was decided by the same Circuit Court and rests upon the *Eldredge* case, are the only cases which may be cited for the proposition that where there is uncertainty as to the ultimate recovery of capital, some portion of each of a series of payments, uncertain as to duration or amount, may be taxed as income, before the taxpayer has recovered the capital value. Judge Mack in the *Eldredge* case seems to have taken the view that some portion of each payment should be taxed as income except in instances where there is a very high degree of uncertainty as to the ultimate recovery of capital. Such a viewpoint disregards the rule that doubts should be resolved in favor of the taxpayer and its application would inevitably lead in many instances to the taxation of capital as income. The rule adopted in the *Eldredge* case for allocating gross receipts as between capital and income is that followed by the petitioner in the instant case and seems to have been adopted on the ground of apparent

reasonableness and from a mistaken analogy to the reasonable allowance as a deduction from "gross income" for depletion in the case of mining properties rather than with due regard to the necessity of carving capital out of gross receipts in order to determine gross income. As hereafter pointed out, Judge Mack erroneously assumed that the rule for determination of income applied in *Ruth Iron Co.* v. *Commissioner* (*supra*) and in the *Klein* case could not be applied in the *Eldredge* case. The *Eldredge* case in fact rests very heavily upon the decision of the Board of Tax Appeals in the *Klein* case which it cites with approval as refusing to follow *Warner* v. *Walsh* (*supra*). Like the *Klein* case it rests upon unsound premises with regard to the certainty of recovery of the taxpayer's capital and the rule for which it appears to stand is one which should not be adopted by this Court.

Discussion of *People ex rel. Knight* v. *Lynch*, 255 N. Y. 323, which is cited by petitioner (Brief p. 29) as *contra* to *Warner* v. *Walsh* (*supra*), and as supporting the proposition that the entire amount of the payments received pursuant to the bequest is liable to tax as income, has been postponed to this point for the reason that an examination of that case discloses that the court was of the opinion that under the statutes of the State of New York it was not accurate to say that a widow, in giving up her dower, purchased an annuity and upon this ground distinguished the case from *Warner* v. *Walsh* (*supra*), *United States* v. *Bolster* (*supra*) and *Allen* v. *Brandeis* (*supra*). The court said with respect to those cases (p. 325):

> "The Appellate Division followed these decisions, stating that practical reason suggests that there should not be contradictory rules relating to the same income. We also share this feeling, but are disinclined to adopt this conclusion for the State of New York in the absence of any final construction of the statute by the United States Supreme Court. There may be a side of this question not presented to, or considered by these Circuit Courts, which we shall state and which leads us under our dower statutes to a different ruling."

Since the court held that the annuity under consideration was not a purchased annuity, it is evident that this case in no way conflicts with the proposition that a taxpayer is entitled to recover *in toto* the purchase price of a purchased annuity or the amount of a bequest falling within the principle announced by this Court in *Burnet* v. *Whitehouse* U. S. , decided April 13, 1931 before being subjected to income tax upon the proceeds thereof.

In view of the contingencies upon which the ultimate recovery of capital by the respondent in this case depends which sufficiently appear from the statement of the case it would seem that upon the authority of the decided cases as well as upon principle, the respondent should be permitted to recover her capital before being subjected to taxation rather than be obliged to run the hazard of failure to recover her capital with the result that the United States may collect the tax upon some portion thereof.

POINT II.

EVEN IF THE PAYMENTS RECEIVED BY THE RESPONDENT DURING 1918 AND 1919 CONSTITUTED IN PART RETURN OF CAPITAL AND IN PART GROSS INCOME, THE SEGREGATION OF CAPITAL FROM INCOME SHOULD BE MADE ON THE SAME BASIS AND BY THE SAME METHOD AS THOSE ADOPTED BY THE PETITIONER IN COMPUTING THE VALUE OF THE RESPONDENT'S RIGHTS TO RECEIVE SUCH PAYMENTS.

If it be assumed, for the sake of argument, that the ultimate recovery of capital by the respondent is certain, and that some part of each payment should be carved out for taxation as income, it is clearly necessary, as above suggested, that the cleavage be made with the most meticulous care, and that the amount to be taxed as income be determined as accurately as the facts permit. The rule adopted by the Commissioner does not conform with this requirement. It proceeds upon a false analogy to allowances for depletion as deductions from gross income; and upon the assumption that any apparently reasonable allowance is sufficient. The truth is that the results reached by the Commissioner are flagrantly inconsistent with the process by which he has computed the amount of the respondent's capital. The Commissioner's valuations of the unpaid purchase price have been made in the manner adopted by him for the valuation of mines. He proceeds upon the assumption which is flatly contrary to the facts, that equal payments will be received by the respondent during each of forty-five years. The value fixed is the

present worth of a series of such equal payments. The tables which have been used in computing this present worth differ from compound discount tables and annuity tables in common use only in that they provide for reinvestment at a different assumed rate of interest from that which is assumed to be earned by the original investment. There is no mystery about such tables. The provision for reinvestment at a different rate of interest from that assumed to be earned by the original investment is the feature which distinguishes the Hoskold type of table from other tables. Ordinary annuity tables enable one at a glance to determine the present worth of a series of equal payments to be received over a definite future term of years at an agreed rate of interest upon the assumption that reinvestment is made at the same rate of interest. The tables used by the Commissioner perform the same office, with the added factor of providing for a return at any agreed rate of interest upon the reinvestment. The same results could be reached in each case by a laborious mathematical computation. The sum of the present worths of each future payment is the present value of the annuity and in this instance the value fixed by the Commissioner is nothing more than the sum of the present worths of the future payments which the Commissioner has assumed that the respondent will receive.

The amount of income included in each annual payment can be determined by anyone familiar with annuity tables as readily as the amount of income subjected to tax was determined in *Ruth Iron Company* v. *Commissioner* (*supra*); *Kosmerl* v. *Commissioner* (*supra*); *Platt* v. *Bowers* (*supra*) and *Klein* v. *Commissioner*

(*supra*). There is no occasion for a distinction between these cases and the present case if it be assumed that a portion of each payment constitutes income and should be taxed. The method of determining the amount of income included in each payment which was adopted by the Board of Tax Appeals in *Klein* v. *Commissioner* (*supra*), in which case it refused to follow *Warner* v. *Walsh* (*supra*), and in its decision in *Appeal of Julia Andrews Bruce* 5 B. T. A. 300, which was overruled by its decision in the present case, is identical with that applied in the *Ruth, Kosmerl,* and *Platt* cases. It is the method approved by those members of the Board who dissented from the result reached in this case.

It seems in fact peculiarly unreasonable and inequitable to determine the value of a series of payments by a process which is exact if the assumed rates of interest be accepted and in which the only element of income consists of interest computed with respect to each instalment and at the next step to determine the amount of income included in each instalment by a rule of thumb method which reaches the result that the amount of income, that is, interest, included in a payment received one year subsequent to the basic date is the same as the amount of interest included in a payment deferred forty-five years.

From the foregoing it will be immediately evident that the Circuit Court for the Sixth Circuit erred in concluding in *Eldredge* v. *United States* (*supra*), at page 929, that

> "* * * The precise method of apportionment employed in the *Klein* and *Ruth* cases is inapplicable here."

and in stating, at page 929, that

> "Reference to compound discount tables is fruitless, since the Formula involves a theoretical sinking fund to take care of the risk element, in addition to a theoretical percentage of return in the nature of interest."

The accuracy of this statement may be doubted since, in a book entitled "Principles of Valuation" by Grimes and Craigue, published in 1928, (New York, Prentice-Hall, Inc.), the authors of which appear to have been engineers in the section of the Bureau of Internal Revenue engaged in the valuation of metal mines, a formula is given by which the present worth of any one of a series of payments which have been valued in accordance with the so-called Hoskold formula may be determined. It seems that the court did not clearly apprehend the nature of the tables used. The rates of interest used were no more theoretical in one case than in the other. It is stated in the opinion, page 929, that in the *Klein* and *Ruth* cases:

> "The percentage of profit was different for each instalment, because the original capital value was calculated for each instalment solely by the discount compounded annually; the difference between such capital value and the actual payment was the taxable profit."

This is true but the introduction of an allowance for interest upon reinvestment at a different rate as an element of the computation constitutes no ground for a different treatment in this case than that which was adopted in the *Klein* and *Ruth* cases. If instead of 4% the assumed rate of interest for reinvestment had been taken at 6%, at which rate the Commissioner discounted the as-

sumed instalments, the method of computation would have been exactly that followed in ordinary annuity tables as to which the Board found no difficulty in making an allocation in the *Klein* case. Moreover, no difficulty was found in making an allocation upon the basis of the tables as a result of the decision of the Board in the overruled *Bruce* case in which the principle applied in the *Klein* and *Ruth* cases was followed.

The underlying principle of the *Klein* and *Ruth* cases was that the amount received by the taxpayer as compensation for deferment of the payments should be taxed as income when the payments fell in. Assuming that some portion of each payment is to be treated as income this is the only sound and equitable basis upon which to determine the amount which is taxable. The method adopted by the Commissioner of assigning an equal portion of each instalment to income is not only contrary to the method of valuation adopted by him but is contrary to the facts since it results in taxing as income a large percentage of the amount which any investor purchasing the payments on the basis contemplated by the Commissioner would be obliged to set apart in the earlier years as capital if the result of his bargain is to be that which the Commissioner contemplates. In other words, the petitioner insists upon valuing the unpaid purchase price here upon a basis which he maintains results in reaching its fair market value and then insists upon taxing the respondent upon a basis which, if it were made one of the conditions of the hypothetical purchase, would be so burdensome that no purchaser would contemplate making the bargain upon that basis.

CONCLUSION.

The respondent maintains that there is no basis for the imposition of the tax sought to be collected for the years 1918 and 1919 for the reasons that she has not recovered and that there is no certainty that she will ever recover either (1) the fair market value at March 1, 1913 of the shares sold by her in 1916 or (2) the value fixed upon the unpaid portion of the purchase price by the petitioner at March 11, 1916, or (3) the value fixed by the Commissioner at March 22, 1917 upon the bequest from her mother. But if it be determined that some portion of each of the payments received by her should be taxed as income, the respondent maintains that the problem is not one of fixing upon a reasonable allowance as a deduction from gross income but involves the necessity of a precise determination of the amount of income included in each payment received by her. The petitioner urges that a rule of thumb method of making the segregation should be adopted. The respondent insists that this method is inconsistent with the Commissioner's method of valuation and is unsound and inequitable in its results. Her position is that if any portion of the payments received is to be taxed as income, that portion should comprise only the compensation for deferment of each payment which is the factor by which the Commissioner reduced the amount which he estimated to be the gross proceeds to a present worth which he calls "fair market value."

It is, therefore, respectfully submitted that the decision of the Circuit Court of Appeals in this case is correct and that its judgment should be affirmed.

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APPENDIX.

STATUTES INVOLVED.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1062, 1064, 1065, 1066, 1067:

SEC. 202. (*a*) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be——

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

SEC. 212. (*a*) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

* * * * * *

SEC. 213. That for the purposes of this title * * * the term "gross income"——

(*a*) Includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also, from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for

the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (*b*) of section 212, any such amounts are to be properly accounted for as of a different period;

(*b*) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

SEC. 214. (*a*) That in computing net income there shall be allowed as deductions:

* * * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar condition in each case, based upon cost including cost of development not otherwise deducted: * * *.

Revenue Act of 1926, c. 19, 44 Stat. 1974, 1982:

SEC. 213. * * *.

(b) The term "gross income" does not include the following items, which shall be exempt from taxation under this title:

* * * * * *

(2) Amounts received * * * under a life insurance endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration

paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * * .

Revenue Act of 1928, c. 852, 45 Stat. 791, 797:

SEC. 22. Gross Income.

(*b*) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * * *

(2) Annuities, etc.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *

SUPREME COURT OF THE UNITED STATES.

Nos. 521 and 522.—October Term, 1930.

521	David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Edith Andrews Logan.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
522	David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Julia Andrews Bruce.	

[May 18, 1931.]

Mr. Justice McReynolds delivered the opinion of the Court.

These causes present the same questions. One opinion, stating the essential circumstances disclosed in No. 521, will suffice for both.

Prior to March, 1913, and until March 11, 1916, respondent, Mrs. Logan, owned 250 of the 4,000 capital shares issued by the Andrews & Hitchcock Iron Company. It held 12% of the stock of the Mahoning Ore & Steel Company, an operating concern. In 1895 the latter corporation procured a lease for 97 years upon the "Mahoning" mine and since then has regularly taken therefrom large, but varying, quantities of iron ore—in 1913, 1,515,428 tons; in 1914, 1,212,287 tons; in 1915, 2,311,940 tons; in 1919, 1,217,167 tons; in 1921, 303,020 tons; in 1923, 3,029,865 tons. The lease contract did not require production of either maximum or minimum tonnage or any definite payments. Through an agreement of stockholders (steel manufacturers) the Mahoning Company is obligated to apportion extracted ore among them according to their holdings.

On March 11, 1916, the owners of all the shares in Andrews & Hitchcock Company sold them to Youngstown Sheet & Tube Company, which thus acquired, among other things, 12% of the Mahoning Company's stock and the right to receive the same percentage of ore thereafter taken from the leased mine.

For the shares so acquired the Youngstown Company paid the holders $2,200,000 in money and agreed to pay annually thereafter for distribution among them 60 cents for each ton of ore apportioned to it. Of this cash Mrs. Logan received 250/4000ths—$137,500; and she became entitled to the same fraction of any annual payment thereafter made by the purchaser under the terms of sale.

Mrs. Logan's mother had long owned 1100 shares of the Andrews & Hitchcock Company. She died in 1917, leaving to the daughter one-half of her interest in payments thereafter made by the Youngstown Company. This bequest was appraised for federal estate tax purposes at $277,164.50.

During 1917, 1918, 1919 and 1920 the Youngstown Company paid large sums under the agreement. Out of these respondent received on account of her 250 shares $9,900.00 in 1917, $11,250.00 in 1918, $8,995.50 in 1919, $5,444.30 in 1920—$35,589.80. By reason of the interest from her mother's estate she received $19,790.10 in 1919, and $11,977.49 in 1920.

Reports of income for 1918, 1919 and 1920 were made by Mrs. Logan upon the basis of cash receipts and disbursements. They included no part of what she had obtained from annual payments by the Youngstown Company. She maintains that until the total amount actually received by her from the sale of her shares equals their value on March 1, 1913, no taxable income will arise from the transaction. Also that until she actually receives by reason of the right bequeathed to her a sum equal to its appraised value, there will be no taxable income therefrom.

On March 1, 1913, the value of the 250 shares then held by Mrs. Logan *exceeded* $173,089.80—the total of all sums actually received by her prior to 1921 from their sale ($137,500.00 cash in 1916 plus four annual payments amounting to $35,589.80). That value also exceeded original cost of the shares. The amount received on the interest devised by her mother was less than its valuation for estate taxation; also less than the value when acquired by Mrs. Logan.

The Commissioner ruled that the obligation of the Youngstown Company to pay 60 cents per ton had a fair market value of $1,942,111.46 on March 11, 1916; that this value should be treated as so much cash and the sale of the stock regarded as a closed transaction with no profit in 1916. He also used this valuation as the basis for apportioning subsequent annual receipts between income and return of capital. His calculations, based upon estimates and as-

sumptions, are too intricate for brief statement.* He made deficiency assessments according to the view just stated and the Board of Tax Appeals approved the result.

The Circuit Court of Appeals held that, in the circumstances, it was impossible to determine with fair certainty the market value of the agreement by the Youngstown Company to pay 60 cents per ton. Also, that respondent was entitled to the return of her capital—the value of 250 shares on March 1, 1913, and the assessed value of the interest derived from her mother—before she could be charged with any taxable income. As this had not in fact been returned, there was no taxable income.

We agree with the result reached by the Circuit Court of Appeals.

The 1916 transaction was a sale of stock—not an exchange of property. We are not dealing with royalties or deductions from gross income because of depletion of mining property. Nor does the situation demand that an effort be made to place according to the best available data some approximate value upon the contract for future payments. This probably was necessary in order to assess the mother's estate. As annual payments on account of extracted ore come in they can be readily apportioned first as re-

*In the brief for petitioner the following appears:

The fair market value of the Youngstown contract on March 11, 1916, was found by the Commissioner to be $1,942,111.46. This was based upon an estimate that the ore reserves at the Mahoning mine amounted to 82,858,535 tons; that all such ore would be mined; that 12 per cent (or 9,942,564.2 tons) would be delivered to the Youngstown Company. The total amount to be received by all the vendors of stock would then be $5,965,814.52 at the rate of 60 cents per ton. The Commissioner's figure for the fair market value on March 11, 1916, was the then worth of $5,965,814.52, upon the assumption that the amount was to be received in equal annual installments during 45 years, discounted at 6 per cent, with a provision for a sinking fund at 4 per cent. For lack of evidence to the contrary this value was approved by the Board. The value of the 550/4000 interest which each acquired by bequest was fixed at $277,164.50 for purposes of Federal estate tax at the time of the mother's death.

During the years here involved the Youngstown Company made payments in accordance with the terms of the contract, and respondents respectively received sums proportionate to the interests in the contract which they acquired by exchange of property and by bequest.

The Board held that respondents' receipts from the contract, during the years in question, represented "gross income"; that respondents should be allowed to deduct from said gross income a reasonable allowance for exhaustion of their contract interests; and that the balance of the receipts should be regarded as taxable income.

turn of capital and later as profit. The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation. When the profit, if any, is actually realized, the taxpayer will be required to respond. The consideration for the sale was $2,200,000.00 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. It had no ascertainable fair market value. The transaction was not a closed one. Respondent might never recoup her capital investment from payments only conditionally promised. Prior to 1921 all receipts from the sale of her shares amounted to less than their value on March 1, 1913. She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture.

"In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." *Doyle* v. *Mitchell*, 247 U. S. 179, 184, 185. Rev. Act 1916, Sec. 2, 39 Stat. 757, 758; Rev. Act 1918, c. 18, 40 Stat. 1057. Ordinarily, at least, a taxpayer may not deduct from gross receipts a supposed loss which in fact is represented by his outstanding note. *Eckert* v. *Commissioner of Internal Revenue*, 282 U. S. — (April 13, 1931). And, conversely, a promise to pay indeterminate sums of money is not necessarily taxable income. "Generally speaking, the income tax law is concerned only with realized losses, as with realized gains." *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

From her mother's estate Mrs. Logan obtained the right to share in possible proceeds of a contract thereafter to pay indefinite sums. The value of this was assumed to be $277,164.50 and its transfer was so taxed. Some valuation—speculative or otherwise—was necessary in order to close the estate. It may never yield as much, it may yield more. If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here. The statute definitely excepts bequests from receipts which go to make up taxable income. See *Burnet, Commissioner*, v. *Whitehouse*, 282 U. S. — (April 13, 1931).

The judgments below are affirmed.